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2Q20
Regulation Outlook

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Executive Summary

The second quarter of 2020 is characterized by publications aimed to manage the impact of the COVID-19 outbreak. In addition, the EU Council published the taxonomy of sustainable activities, and the ECB launched a public consultation on the draft guide on climate-related and environmental risks. At the local level, the BoS published Circulars 2/2020 and 3/2020 amending Circular 4/2017 to credit institutions on public and confidential financial reporting standards and financial statement formats

Publications related to the outbreak of COVID-19

Global publications

- At international level, the Basel Committee on Banking Supervision (BCBS) issued some **measures to reflect the impact of COVID-19** which sets out technical guidance related to the exceptional measures introduced by governments and banks to alleviate the impact of the virus.
- International Organization of Securities Commissions (IOSCO) published the **Statement on Importance of Disclosure about COVID-19** and the International Accounting Standards Board (IASB) issued a guidance document on **Accounting for expected credit losses (ECL) applying IFRS 9 Financial Instruments**.

European publications

- In Europe, the European Commission (EC) announced the **Banking Package** to facilitate bank lending on supporting households and businesses in the EU.
- The European Central Bank (ECB) issued **temporary measures to mitigate impact of possible rating downgrades on collateral availability**, which complements the broader collateral easing package that was announced on April.
- The European Securities and Markets Authority (ESMA) published a **public statement on implications of the COVID-19 outbreak on the half-yearly financial reports**, which promotes transparency and consistent application of European requirements for the information provided on the interim financial statements according to IFRS.
- The European Insurance and Occupational Pensions Authority (EIOPA) issued an **statement on principles to mitigate the impact of COVID-19** on the occupational pensions sector, as well as to avoid pro-cyclical effects on the real economy and the financial system.
- The European Banking Authority (EBA) issued a **preliminary analysis of impact of COVID-19 on EU banks** mainly based on supervisory reporting data submitted by EU banks until the end of April.

Local publications

- In Spain, the Bank of Spain (BoS) published the **Economic Bulletin 2/2020: Reference Macroeconomic Scenarios for the Spanish Economy after COVID-19**, which develops a set of scenarios for the Spanish economy that take into account different alternative assumptions about the duration of confinement and the persistence of the disturbance suffered.
- In addition, the Spanish Government has approbed **Royal Decree-Law 15/2020** on urgent complementary measures to support the economy and employment and **Royal Decree Law 19/2020** adopting complementary measures in the agricultural, scientific, economic, employment and social security and tax fields to alleviate the effects of COVID-19.
- In the US, the Federal Reserve (Fed), Office of the Controller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC) and Treasury have issued **Temporary Changes to the Community Bank Leverage Ratio Framework** with the aim to support the US economy and allow banking organizations to continue lending to households and businesses.
- In the UK, the Prudential Regulation Authority (PRA) and the Bank of England (BoE) published a **statement on resolution measures and COVID-19** aimed at alleviating operational burdens on PRA-regulated firms in response to the COVID-19 outbreak.
- Furthermore, the Financial Conduct Authority (FCA) published several **temporary guidances for firms which cover personal loans overdraft and credit cards (including retail revolving credit) and coronavirus**, with the aim of protecting consumers by providing them with temporary support in the light of the current exceptional circumstances arising out of coronavirus.

Other publications of interest

Global publications

- At international level, the Financial Stability Board (FSB) published a **guidance on financial resources to support central counterparty (CCP) resolution and on the treatment of CCP equity in resolution**, that focuses on the assessment of the adequacy of financial resources and of the treatment of equity in the context of resolution.
- The BCBS announced the **progress in adopting the Principles for effective risk data aggregation and risk reporting**, and the **Basel III Monitoring Report**.
- IOSCO published a **consultation report on outsourcing principles** which comprise a set of fundamental precepts and seven principles.
- The IASB has issued the **phase 2 of the Interest Rate Benchmark Reform** which includes proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16.

European publications

- At European level, the Single Resolution Board (SRB) published the **Minimum Required Eligible Liabilities (MREL) Policy under the Banking Package** with aim of the adaptation of MREL requirements to the new framework.
- The Council published the First reading position on the **taxonomy of sustainable activities** which containts a common EU-wide classification system. For its part, the ECB launched a **public consultation on the draft guide on climate-related and environmental risks** and the ESAs published the **joint consultation paper on Environmental, Social & Governance (ESG) disclosures standards** for financial market participants, advisers and products.
- The ESMA published a **consultation paper on Draft Guidelines on outsourcing to cloud service providers** with the aim to help firms to identify, address and monitor the risks that may arise from their cloud outsourcing arrangements.
- The EIOPA published a **discussion paper on (re)insurance value chain and new business models arising from digitalisation**.
- The EBA issued a **final report on the Guidelines on credit risk mitigation (CRM) for institutions applying the internal ratings-based (IRB) approach with own estimates of Loss Given Defaults (LGDs)**, as well as the **guidelines on loan origination and monitoring**. Furthermore, it also announced the data of the **Spring 2020 EU-wide transparency exercise**.

Local publications

- At local level, in Spain, the BoS issued **Circulars 2/2020** and **3/2020 amending Circular 4/2017 to credit institutions on public and confidential financial reporting standards and financial statement formats**, with the aim to adapt Circular 4/2017 to the changes in the international regulations on information requirements for credit institutions, and to allow institutions to make greater use of flexibility in credit risk management practices and the accounting of ECL. In addition, the Government of Spain has approved the **Climate Change and Energy Transition Law Project**, which aims to, among others, ensure compliance with the objectives of the Paris Agreement of 2015.
- In the US, the Fed, FDIC and OCC published the **Regulatory Capital Rule on Temporary Exclusion of US Treasury Securities and Deposits at Federal Reserve Banks from the Supplementary Leverage Ratio (SLR) for Depository Institutions** with the aim of establishing temporary modifications that will provide flexibility to certain depository institutions to expand their balance sheets in order to provide credit to the real economy.
- In the UK, the PRA published the **Policy Statement 11/20 on credit risk: probability of default (PD) and loss given default (LGD) and LGD estimation** which updates again the supervisory statement 11/13 on IRB.

Regulatory projections

At European level, the EBA RTS on criteria to define managerial responsibility and control functions will apply. At local level, the legal regime for FCIs will enter into force. In USA, the Fed Final Rule for determining whether a company controls another company for purposes of the BHCA or the HOLA will apply.

Regulatory projections*

1. **Next quarter**

- **(Europe) July 2020**: the EBA RTS on criteria to define managerial responsibility and control functions, a material business unit and a significant impact on its risk profile, and categories of staff will apply.
- **(Spain) July 2020**: the legal regime for FCIs will enter into force.
- **(Europe) September 2020**:
  - The ESMA Final GL on liquidity stress testing in Undertakings for the Collective Investment in Transferable Securities (UCITS) and the Alternative Investment Funds (AIFs) will apply.
  - The EBA Guidelines on the determination of the weighted average maturity (WAM) of the contractual payments due under the tranche in accordance with CRR will apply.
- **(US) September 2020**: the Fed Final Rule for determining whether a company controls another company for purposes of the Bank Holding Company Act (BHCA) or the Home Owners' Loan Act (HOLA) will apply.

2. **Next year**

- **(US) October 2020:**
  - The firm's first stress buffer requirements set by the Fed would generally be effective.
  - The Fed Final Rule to simplify and tailor compliance requirements relating to the Volcker Rule will enter into force.
- **(Global) December 2020**: the BCBS GL on step-in risk will be applicable.
- **(Europe) December 2020**: the ECB Regulation (EU) 2018/1845 on the materiality threshold for credit obligations past due will be applicable.
- **(Spain) December 2020**: credit institutions will apply the significance threshold of the credit obligations specified in the Circular 3/2019 of the BdE and the Circular 4/2019 on public and reserved financial information standards and model financial statements of the BdE.
- **(Europe) 2020**:
  - Its expected that the EC adopts the Final RTS on SA-CCR published by the EBA on 2019 defining its date of application.
  - The EU's taxonomy for climate change mitigation and climate change adaptation will be fully applicable.
- **(Global) January 2021**: the IASB Phase 2 of the Interest Rate Benchmark Reform, with proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 will apply.
- **(Europe) January 2021**:
  - The EBA GL on the new definition of default will be applicable.
  - The EBA GL on CRM for institutions applying the advanced internal rating-based (A-IRB) approach will be applicable.
- **(Europe) March 2021**:
  - The EP and the Council Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector will enter into force.
  - The RTS on environmental, social and governance (ESG) disclosure standards will apply.
- **(Europe) 2021**: EIOPA's occupational retirement provisions stress test results will be published.

(*) The regulatory projections have been updated with the information available up to the date of publication of the report, on the modified deadlines as part of the flexibility measures adopted by different authorities in relation to the management of COVID-19.

2. Next year (cont.)

- **(Europe) June 2021**:
  - The CRR II of the EP and the Council will be applicable with certain exceptions.
  - The EP and the Council adaptation of the investment firms prudential framework will be applicable.
  - The EBA Guidelines on loan origination and monitoring will enter into force.
  - The ESMA Guidelines on outsourcing to cloud service providers will enter into force.
  - The EBA new regulatory framework for investment firms will enter into force.
  - The EBA Final draft comprehensive ITS on institutions' Pillar 3 disclosures will apply.
  - The EBA Final draft ITS on supervisory reporting (Framework 3.0) will apply.
- **(Europe) July 2021**: the amendments introduced by the CRR II which have an impact on the ECB Guide on internal models will apply.
- **(US) July 2021**: FED and FDIC Final Rule on modifications to resolution plan requirements will be applicable for companies subject to category I, II and III standards.
- **(Europe) September 2021**: the EBA's ITS on specific reporting requirements for market risk will apply.

3. More than a year

- **(Global) December 2021**: the BCBS new assessment methodology for G-SIBs will be applicable.
- **(Europe) December 2021**: a new stress test methodology is expected to be approved.
- **(UK) December 2021**: the PRA will next reassess firms' SRB rates.
- **(Europe) 2022**: the proposed framework would be introduced in the 2022 EU-wide stress test.
- **(Europe) January 2022**:
  - The EBA GL on IRB parameters estimation will be applicable.
  - The EBA final RTS on an economic downturn as well as the GL for the estimation of LGD appropriate for an economic downturn will be applicable.
  - The ESAs provisions regarding product disclosure in periodic reports RTS on ESG disclosure standards will apply.
  - The EBA GL on CRM for institutions applying the IRB approach with own estimates of LGDs will apply.
- **(UK) January 2022**:
  - The PRA will require firms to comply with an end-state MREL.
  - The PRA PS 11/20 on credit risk: PD and LGD estimation will enter into force.
- **(US) July 2022**: the Final Rule of the Fed and the FDIC on modifications to resolution plan requirements for covered companies that are triennial reduced filers will apply beginning July 2022.
- **(Europe) July 2022**: It will be applicable the EP and Council Directive (EU) 2019/2162 and Regulation (EU) 2019/2160 on exposures in the form of covered bonds.
- **(Europe) December 2022**: the EBA will issue an impact assessment of MREL on banks' profitability.
- **(Global) January 2023**:
  - The revised SA for credit risk, the revised IRB framework, the revised CVA framework, the revised operational and market risk framework published in Basel III and the standard on the minimum capital requirements for market risk by the BCBS will be implemented. Moreover, the LR framework using the revised exposure definition and the G-SIB buffer will be applicable.
  - Most of the new disclosure requirements of the BCBS Pillar III updated framework will have to be implemented.
  - The BCBS technical amendment on the capital treatment of securitisations of NPLs will enter into force.
- **(Europe) January 2024**:
  - SRB's deadline of meeting external and internal MREL, including subordination requirements.
- **(Global) January 2028**: an output floor of 72.5% of RWA in the SA approach will be applicable according to the Basel III reform.

Publications of the quarter

Summary of outstanding publications of this quarter

04/05/2020

Consultative Document on Addressing the regulatory, supervisory and oversight challenges raised by “global stablecoin” arrangements

1. Context

In June 2019, the G20 called on the FSB to examine regulatory issues raised by so-called “global stablecoin” (GSC) arrangements and to advise on multilateral responses as appropriate, taking into account the perspective of emerging market and developing economies. Later in February 2020 the G20 reiterated the importance of evaluating and appropriately addressing the risks of GSC arrangements before they commence operation and supported the FSB’s efforts to develop regulatory recommendations with respect to these arrangements.

In this context, the FSB has published a **Consultative Document on Addressing the regulatory, supervisory and oversight challenges raised by “global stablecoin” arrangements** which explains the characteristics and risks posed by GSC arrangements andtfg proposes 10 high-level recommendations that are addressed to regulatory authorities at jurisdictional level to advance consistent and effective regulation and supervision of GSC arrangements.

2. Main points

- **Description of GSCs and how they differ from other crypto-assets and other stablecoins**. A global stablecoin is a crypto-asset that aims to maintain a stable value relative to a specified asset, or a pool or basket of assets. The main characteristics of a global stablecoin that distinguishes it from other crypto-assets are:
  - The value of the stablecoin is stabilised through the use of a stabilisation mechanism which can be asset-linked or algorithm-based on changes in demand.
  - A stablecoin arrangement typically provides three core functions: i) issuance, redemption and stabilisation of the value of the coins; ii) transfer of coins, and iii) interaction with coin users for storing and exchanging coins.
  - The attribute global refers to the potential extent of the stablecoin’s use as a means of payment or store of value in multiple jurisdictions.
- **Potential risks and vulnerabilities raised by GSCs**. Even though nowadays GSCs pose financial risks which are contained, if the use of stablecoins increase this could also create financial stability risks. Among some of the potential risks raised by GSCs we found:
  - If they are used as a common store of value even a moderate variation in its value might cause significant fluctuations in users’ wealth.
  - If widely used for payments, any operational disruption in the GSC arrangement might have significant impacts on economic activity and financial system functioning.
  - Exposures of financial institutions might increase in scale and change in nature – particularly if financial institutions played multiple roles within a GSC arrangement.

  The FSB also highlights some of the potential vulnerabilities raised by GSCs:
  - Traditional financial risks (e.g. market, liquidity and credit risk) in a GSC arrangement.
  - Potential fragilities in the governance, operation and design of the GSC arrangement’s infrastructure.
  - Applications and components on which users rely to store private keys and exchange coins.
- **Regulatory, supervisory and oversight approaches to GSCs**. On the one hand, it has been posed the application of international financial standards such as anti-money laundering and counter-terrorism financing rules published by Financial Action Task Force (FATF) or the Principles for Financial Market Infrastructures (PFMI) to GSC activities. On the other hand, most jurisdictions do not currently have regulatory regimes specific to crypto-assets in general or stablecoins in particular. Likewise, in most jurisdictions, existing regulatory, supervisory and oversight approaches, while not specific to crypto-assets or stablecoins, would apply in whole or part and would address some of the risks associated with stablecoins or with entities that are part of the stablecoin arrangement. For this reason, the authorities have planned to clarify how existing regimes apply to stablecoins and their providers, and that some adaptation of their regulation may be necessary to cover pending issues in regulation (e.g. incomplete implementation and coverage of FATF standards, insufficient risk mitigation tools within a regulatory framework applicable, etc.)
- **Challenges in a cross-border context**. Cross-border challenges are inherent to GSC arrangements because a stablecoin issued in one jurisdiction may be easily accessible online to users in another jurisdiction and operational and cyber security risks, related to the technology and infrastructure used in a stablecoin arrangement, may affect multiple jurisdictions. Furthermore, addressing the cross-border challenges requires effective cross-border cooperation, coordination and information sharing amongst the relevant authorities to ensure sufficient cross-border supervision and oversight of the stablecoin arrangement.
- **High-level recommendations**. This document sets out 10 high-level recommendations which aim to mitigate the potential risks with the use of GSCs as means of payment and/or store of value, both at the domestic and international level, while supporting responsible innovation and providing sufficient flexibility for jurisdictions to implement domestic approaches. These recommendations focus on reinforcing and underscoring existing standards and regulations; identifying and addressing potential regulatory gaps; and mitigating potential regulatory arbitrage.

3. Next steps

- Comments on this consultative document and responses to a set of questions established in it should be sent by **15 July 2020**.

11/05/2020

Guidance on financial resources to support central counterparty (CCP) resolution and on the treatment of CCP equity in resolution

1. Context

In November 2018, the FSB published a discussion paper Financial resources to support CCP resolution and the treatment of CCP equity in resolution, that set out considerations that may be relevant for authorities and crisis management groups (CMGs) with regard to evaluating whether existing financial resources and tools are adequate to implement the resolution strategy for individual CCPs and considerations that could guide authorities in developing possible approaches to the treatment of CCP equity in resolution.

In this context, the FSB has published a **Guidance on financial resources to support CCP resolution and on the treatment of CCP equity in resolution** that focuses on the assessment of the adequacy of financial resources and of the treatment of equity in the context of resolution, in order to help jurisdictions in determining whether there is a gap in the resources and tools available for resolution that must be addressed.

2. Main points

- **Assessment of the adequacy of financial resources to support CCP resolution**. This guidance establishes a five-step process for assessing the adequacy of financial resources and tools available to authorities to support the resolution of a CCP:
    - Step 1. Identifying hypothetical default and non-default loss scenarios (and a combination of them) that may lead to resolution.
    - Step 2. Conducting a qualitative and quantitative evaluation of existing resources and tools available in resolution. In particular, the objective would be to evaluate for each scenario:
        - The **availability of existing resources**, including resources available to cover relevant costs.
        - The **ability to rely on particular tools** to create resources.
        - The **potential that the use of these resources or tools** would have an adverse effect on financial stability.
    - Step 3. Assessing potential resolution costs that could arise in the resolution of a CCP in the various scenarios identified in Step 1. Such costs include both losses and costs that must be covered by available resources.
    - Step 4. Comparing existing resources and tools to resolution costs and identifying any gaps. This analysis should consider, among other, the availability and sufficiency of existing resources and tools to cover the type of costs they are intended for and to cover other type of costs, or the time horizon for executing the resolution strategy and the manner for paying resolution costs.
    - Step 5. Evaluating the availability, costs and benefits of potential means of addressing any identified gaps. In particular, the resolution authority (RA) should consider at least the following points:
        - Whether **additional tools or resources** may be necessary to **support resolution**.
        - What **options** exist for **addressing** any identified **gaps**.
        - The **costs**, **benefits** and likely **unintended consequences** of each option.
        - How to **involve** the relevant **oversight and/or supervisory authorities** to close the potential gaps.
        - The **financial stability implications** of each option.
        - Whether the resolution strategy could be adjusted to **optimise the use of available financial resources**, either as a standalone option to address any identified gap or in addition to requiring additional financial resources.

2. Main points (cont.)

- **Treatment of CCP equity in resolution**. One of the objectives of an effective resolution regime is to provide mechanisms enabling shareholders and creditors to absorb losses in a manner that respects the hierarchy of claims in liquidation. Thus, in a resolution CCP equity should absorb losses first, that CCP equity should be fully loss-absorbing, and RAs should have powers to write down (fully or partially) CCP equity. In this sense, this guidance sets outs a framework for the RAs to assess the treatment of CCP equity in resolution:
  - Addressing the treatment of CCP equity in resolution plans. Based on the analysis on the impact that any limits on the amount of CCP equity exposed to losses have on its ability to take appropriate action to achieve the treatment of CCP equity, the RA, in cooperation with the CCP's oversight and/or supervisory authorities, may decide to adjust the exposure of CCP equity to losses or consider additional options to address the identified limitations.
  - Mechanisms for adjusting the treatment of CCP equity in resolution. A RA should consider and incorporate in the resolution strategy possible mechanisms for adjusting the exposure of CCP equity to losses in resolution to achieve the correct treatment of CCP equity. Among other, possible adjustment mechanisms include dilution of existing ownership by raising new capital through conversion or issuance of new shares.
  - Implementing policy for the treatment of CCP equity in resolution. Based on the analysis undertaken in accordance with the previous sections, the relevant home authorities should address the challenges relating to CCP equity fully bearing losses in resolution. This may include, where possible, that home authorities having the relevant powers and authority require that CCPs modify their capital structures, rules or other governance documents in a manner that subordinates shareholders to other creditors or sets out the point at which equity absorbs losses in legally enforceable terms.

3. Next steps

- The FSB will consider in **five years after** the publication of the final guidance, in consultation with the Committee on Payments and Market Infrastructures-International Organization of Securities Commissions (CPMI-IOSCO), whether further adjustments are needed to this guidance in light of market developments and resolution authorities' experience with using the guidance.

20/04/2020
Measures to reflect the impact of COVID-19

1. Context

Governments and banks in many jurisdictions have introduced extraordinary measures to alleviate the financial and economic impact of COVID-19. The relief measures include a range of different payment moratoriums and government guarantees. This measures have an impact on the expected credit losses (ECLs) of banks and risk-based capital requirements.

In this context, the BCBS has issued **Measures to reflect the impact of COVID-19** which sets out technical guidance related to the exceptional measures introduced by governments and banks to alleviate the impact of the COVID-19 and ECL accounting. The guidance seeks to ensure that banks reflect the risk-reducing effect of the exceptional measures when calculating their capital requirements. It also sets out the amended transitional arrangements for the regulatory capital treatment of ECL accounting, which will provide jurisdictions with greater flexibility in how to phase in the impact of ECL on regulatory capital.

2. Main points

- **Treatment of extraordinary support measures related to COVID-19**.
  - Loans subject to government guarantees. When determining a bank's credit risk requirement for loans that are subject to sovereign guarantees, the relevant sovereign risk weight should be used, as set out in the IRB and Standardized approach of the Basel Framework.
  - Loans subject to payment moratoriums and non-performing assets. BCBS has agreed that payment moratorium periods relating to the COVID-19 outbreak can be excluded by banks from the counting of days past due. Also, the BCBS has agreed that bank's assessments should be based on whether the borrower is unlikely to repay the rescheduled payments.
  - Exposures subjected to forbearance. BCBS has agreed that if borrowers accept the terms of a payments moratorium or have access to other relief measures such as public guarantees, this should not automatically lead to the loan being categorised as forborne.
- **ECLs**. BCBS expects ECL estimates to reflect the mitigating effect of the significant economic support and payment relief measures put in place by public authorities and the banking sector using the flexibility inherent in IFRS 9.
- **Transitional arrangements**. BCBS has agreed on the following amendments to the existing transitional arrangements for the regulatory capital treatments of ECLs:
  - Jurisdictions may apply the existing transitional arrangements even if they were not initially implemented when banks first adopted the ECL model.
  - Jurisdiction allow to switch from the static approach to the dynamic approach to determine the transitional adjustment amount.
  - Jurisdictions may use alternative methodologies that aim to approximate the cumulative difference between provisions under the ECL accounting model and provisions under the prior incurred loss accounting model.
  - For the 2 year period comprising the years 2020 and 2021, jurisdictions may allow banks to add-back up to 100% of the transitional adjustment amount to CET1. The "add-back" amount must then be phased-out on a straight line basis over the subsequent 3 years.

11/05/2020
Progress in adopting the Principles for effective risk data aggregation and risk reporting

1. Context

In January 2013, the BCBS issued the principles for effective risk data aggregation and risk reporting (RDA&RR). These principles, which became effective in January 2016, aim to improve risk management practices and decision-making processes by strengthening banks' risk data aggregation and risk reporting practices. Since the publication of this framework, the BCBS has been monitoring banks' implementation issuing progress reports, the last one on June 2018.

In this context, the BCBS has published its sixth **Progress report on bank´s adoption of the RDA&RR principles**. This report provides an overview of banks' extent of compliance with the principles, including key observations by supervisors; analyses the implementation of the principles by global systemically important banks (G-SIBs); and proposes key recommendations to further facilitate implementation.

2. Main points

- **Scope of the assessment**. Supervisors in 12 jurisdictions with G-SIBs under their supervision completed an assessment questionnaire, whose responses included 34 banks designated as G-SIBs between 2011 and 2019.
- **Assessment results**. Supervisors were asked to rate their banks' current levels of compliance with each of the principles, and the results show that:
    - Banks have made notable improvements in their implementation of the principles since the previous assessment, especially on governance, risk data aggregation capabilities and risk-reporting practices. However, some banks still have to make further improvements of their data architecture and IT infrastructure.
    - More banks obtained the "largely compliant" or "fully compliant" ratings for all principles. Another positive aspect is that no bank attracted the lowest rating for any of the principles. Banks made substantial progress in implementing Principle 1 and 2.
    - No bank was assessed as "fully compliant" with all the principles in the 2019 assessment.
- **Key observations by supervisors**. The assessment reflects that, among others:
    - There has been notable improvements in banks' overarching governance, risk data aggregation capabilities and reporting practices (e.g. banks have established enterprise data strategies and data management frameworks).
    - The aggregation processes of some banks are still not appropriate, in terms of their current capabilities in relation to their size, complexity and activities.
    - Banks continue to experience difficulties in implementing the principles across an entire banking group and in managing the interdependencies between RDA&RR programmes and other bank-wide strategic projects (e.g. the complexity and interdependence of projects to address IT legacy systems).
    - Supervisors have applied a range of assessment techniques (e.g. thematic reviews, fire drills) which focus on banks' implementation of the principles.
- **Adoption of the proportionality concept**. Banks are responsible for defining the scope of their compliance with the principles and for ensuring that their implementation remains comprehensive and aligned with their business activities, bearing in mind that proportionality concept should not be applied in a way that undermines the effectiveness of their risk management and decision-making processes, as long as the aim of proportionality is to reflect the relative differences in risk profiles across banks.
- **Key recommendations**. The BCBS proposes three new recommendations:
    - Banks should monitor their efforts to implement the principles and make appropriate modifications to governance, IT infrastructure, and data aggregation and reporting capabilities as risks, activities and technologies evolve.
    - Banks should promptly and appropriately address weaknesses as well as review and update the principles' implementation roadmaps.
    - Supervisors should communicate to the banks any changes in regulations or supervisory focus.

3. Next steps

- The BCBS will continue to monitor G-SIBs' progress in adopting the principles.
- Most banks expect to have implemented the principles fully or in large part by the **end of 2020**.

20/04/2020

- **BCBS - Basel III Monitoring Report**
- **EBA Report on Basel III Monitoring**
- **EBA Report on Liquidity Measures**
- **EBA updates 2019 list of Other Systemically Important Institutions (O-SIIs)**

1. Context

In 2016, the BCBS published an updated standard for the regulatory capital treatment of securitisation exposures for simple, transparent and comparable (STC) securitisations. In the same year, the standard on minimum capital requirements for market risk (FRTB) was also published, and it has been recently revised in January 2019. Furthermore, in December 2017, the BCBS published the final set of revisions to the Basel III framework addressing undue variability in risk-weighted assets (RWAs) calculations and amending, credit risk calculation methods (SA and IRB), credit valuation adjustment (CVA), calculation method for operational risk (SMA) which replaces the previous ones, and establishes an output floor. It also modifies the exposure measure of the leverage ratio (LR) and introduces an additional buffer on this ratio for global systemically important banks (G-SIBs).

In this context, the BCBS has published the results of its latest **Basel III monitoring** report which sets out the impact of the finalisation of the Basel III reforms, and for the first time, it also reflects the finalisation of the market risk framework published in January 2019. In parallel with this report, the EBA has issued a **Report on its Basel III monitoring exercise** which includes a preliminary assessment of the impact of the Basel reform package on EU banks, assuming its full implementation.

Along with this document, the EBA has also published a **Report on liquidity measures** that monitors and evaluates the liquidity coverage requirements currently in place in the EU, and the updated **2019 list of Other Systemically Important Institutions (O-SIIs)**.

2. Main points

BCBS - Basel III Monitoring Report

- **Sample of banks**: 174 banks, including:
  - Group 1: 105 internationally active banks that have Tier 1 capital of more than €3 billion; and where 30 institutions have been designated as G-SIBs.
  - Group 2: 69 banks that have Tier 1 capital of less than €3 billion or are not internationally active (i.e. all other banks).
- **Reference date**: the results are based on data as of 30 June 2019. Therefore, the impact of COVID-19 in not taken into account.
- **General aspects**:
  - This Report does not take into account any transitional arrangements (i.e. phase-in of deductions and grandfathering).
  - This Report does not reflect any additional capital requirements under Pillar 2 of the Basel II framework, any higher loss absorbency requirements for domestic systemically important banks, nor does it reflect any countercyclical capital buffer requirements.
  - Changes in minimum required capital from fully phased-in final Basel III remain stable for large internationally active banks compared with end-2018, including the recently recalibrated market risk standards aside.

	31 December 2018			30 June 2019		
	Group 1	G-SIBs	Group 2	Group 1	G-SIBs	Group 2
Increase of the mínimum requirement of Tier 1 MRC[1]	3.0%	3.4%	8.5%	2.8%	3.1%	7.5%
CET1 ratio (%)	12.2%	12.1%	13.0%	12.3%	12.2%	12.2%
Target capital shortfalls[2] (MM€)	24.7	22.8	3.8	20.3	18.3	3.4
TLAC shortfalls (MM€)	78.0	78.0	N/A	46.5	46.5	N/A

(1) Minimum required capital
(2) Tier 1 + Tier 2

2. Main points (cont.)

EBA Report on Basel III Monitoring

- **Sample of banks**: 105 banks form 19 European Economic Area (EEA) countries, including:
  - Group 1: 42 banks internationally active banks that have Tier 1 capital of more than €3 billion, of which 11 are G-SIIs.
  - Group 2: 63 banks that have Tier 1 capital of less than €3 billion or are not internationally active (i.e. all other banks).
- **Reference date**: the results are based on data as of 30 June 2019. Therefore, the impact of COVID-19 in not taken into account.
- **General aspects**:
  - This Report assesses the impact on EU banks of the final revisions of credit risk, operational risk, and leverage ratio frameworks, as well as of the introduction of the aggregate output floor. It also quantifies the impact of the new standards for market risk (FRTB) and credit valuation adjustments (CVA).
  - The impact is assessed on the assumption of the full implementation of the Basel reforms (i.e. 2028).
  - The Report presents the impact of the reforms in terms of changes in CET1, Tier 1 and additional Tier 1 MRC, comparing the fully implemented revised Basel III requirements with the fully phased-in CRR / CRD IV requirements.

Change in total T1 MRC (weighted average in %) Reduced estimation bias

Group	Credit Risk				Market risk	CVA	Op. risk	Output floor	Total risk-based	Revised	Total
	SA	IRB	Securit.	CCPs							
All banks	1.8	1.8	0.4	0.0	0.5	4.3	5	6.5	20.2	-4.1	16.1
1	1.5	1.5	0.4	0.0	0.6	4.6	5.5	6.8	20.8	-3.5	17.3
G-SIB	1.7	1.7	0.6	0.0	0.8	4.7	6.3	6.7	22.4	0.3	22.7
2	4	3.9	0	0	0.4	2.3	1.4	4.1	15.9	-7.7	8.1

Change in total T1 MRC (weighted average in %) Conservative estimation

Group	Credit Risk				Market risk	CVA	Op. risk	Output floor	Total risk-based	Revised	Total
	SA	IRB	Securit.	CCPs							
All banks	1.8	1.8	0.4	0.0	1.6	4.3	5	6.5	21.2	-4.2	17
1	1.5	1.5	0.4	0.0	1.7	4.6	5.5	6.8	22	-3.7	18.3
G-SIB	1.7	1.7	0.6	0.0	2.7	4.7	6.3	6.7	24.3	0.1	24.4
2	4	3.9	0	0	0.4	2.3	1.4	4.1	15.9	-7.7	8.1

EBA Report on Liquidity Measures

- **Objective**. This Report provide a three annual update on the monitoring of the liquidity coverage requirements. The analysis is based on the Common Reporting Framework (COREP) data of June 2019.
- **Main results**.
  - The weighted average liquidity coverage ratio (LCR) across banks is 147% and it has increased since December 2017.
  - In June 2019, there were only three banks with LCR levels below 100%, as they monetised their liquidity buffers during times of stress.
  - The average LCR level for the majority of the countries is within the 100-200% range, although there are some differences in terms of the dispersion of banks' LCR levels within countries.

List of Other Systematically Important Institution (O-SIIs) 2019

- **O-SIIs**. The EBA has updated the 2019 list of O-SIIs according to EBA Guidelines based on the size, importance, complexity, cross-border activities and interconnectedness of institutions. This list also reflects the additional capital buffers that the relevant authorities have set for the identified O-SIIs.

02/06/2020
Consultation Report on outsourcing principles

1. Context

In September 2005, IOSCO published a report on Principles on Outsourcing of Financial Services for Market Intermediaries which set out principles that are designed to assist market intermediaries in determining the steps they should take when considering outsourcing tasks. The report also contained some broad principles to assist regulators in addressing outsourcing in their regular risk reviews of entities. Subsequently, in July 2009, IOSCO published a report on Principles on Outsourcing by Markets to address the risks relevant to outsourcing and the use of third parties in the context of secondary trading in securities markets. However, in the last ten years, the trading landscape for firms and markets has changed considerably, and this has made necessary an update on this reports.

In this context, the IOSCO has published a **Consultation Report on outsourcing principles** which comprise a set of fundamental precepts and seven principles. The fundamental precepts cover issues such as the definition of outsourcing, the assessment of materiality and criticality, affiliates, sub-contracting and outsourcing on a cross-border basis. The seven principles set out expectations for regulated entities that outsource tasks, along with guidance for implementation.

2. Main points

- **Fundamental Precepts**:
  - Scope: the Principles on Outsourcing should apply to trading venues, market intermediaries and market participants acting on a proprietary basis, credit rating agencies, and financial market infrastructures that are regulated under the relevant legal regime of a jurisdiction.
  - Outsourcing definition: it is considered to be a business practice in which a regulated entity uses a service provider to perform tasks, functions, processes, services or activities that would, or could in principle, otherwise be undertaken by the regulated entity itself.
  - Responsibility for outsourcing: the regulated entity retains full responsibility, legal liability, and accountability to the regulator for all tasks that it may outsource to a service provider to the same extent it would if the service were provided in-house.
  - Potential benefits of outsourcing: it permits financial entities to obtain necessary expertise at a lower cost, it helps automate and speed up tasks or it provides flexibility to the business models of regulated entities, among others.
  - Potential risks and challenges:
    - **Lack control over some outsourced tasks**.
    - An increase of the number of **cyber incidents and data leaks**.
    - **Operational disruptions** to the services.
    - An increase of the **concentration in the number and/or materiality of the services** that are outsourced.
    - The **integrity and effectiveness** of financial services regulatory and **supervisory regimes** and systems.
  - Assessment of materiality and critically: although the assessment of what is material or critical is often subjective, some factors should be considered by the regulated entity, but not limited to the: potential negative impacts on investor protection or directly on clients; financial, reputational, and operational impact on the regulated entity of the failure of a service provider; or the impact on an entity’s control functions and risk management; among others.
  - Affiliates: these Principles apply regardless of whether outsourced tasks are performed by an affiliated entity of a corporate group or by an entity that is external to the corporate group.
  - Outsourcing on a cross-border basis: additional risks arising from outsourcing on a cross-border basis which may require attention during the due diligence process and contract negotiations:
    - Service providers may use the **services of a sub-contractor to perform the outsourced tasks**, but the regulated entity should ensure: (i) sub-contracting is not permissible without its prior approval; (ii) the ability of the sub-contractor to continuously perform the services; (iii) accessing data maintained by the sub-contractor.
    - Where multiple regulated entities use a **common service provider**, operational risks are correspondingly concentrated, and may increase to the extent they present a systemic risk.

2. Main points (cont.)

- **Principles**. The seven principles set out expectations for regulated entities that outsource tasks, along with guidance for implementation. They comprise that the regulated entity should:
  - Principle 1: conduct suitable due diligence processes in selecting an appropriate service provider and in monitoring its ongoing performance.
  - Principle 2: enter into a legally binding written contract with each service provider, the nature and detail of which should be appropriate to the materiality or criticality of the outsourced task to the business of the regulated entity.
  - Principle 3: take appropriate steps to ensure both the regulated entity and any service provider establish procedures and controls to protect the regulated entity's proprietary and client-related information and software and to ensure a continuity of service to the regulated entity, including a plan for disaster recovery with periodic testing of backup facilities.
  - Principle 4: take appropriate steps to ensure that service providers protect confidential information and data related to the regulated entity and its clients, from intentional or inadvertent unauthorised disclosure to third parties.
  - Principle 5: be aware of the risks posed, and should manage them effectively, where it is dependent on a single service provider for material or critical outsourced tasks or where it is aware that one service provider provides material or critical outsourcing services to multiple regulated entities including itself.
  - Principle 6: take appropriate steps to ensure that its regulator, its auditors, and itself are able to obtain promptly, upon request, information concerning outsourced tasks that is relevant to contractual compliance and/or regulatory oversight including, as necessary, access to the data, IT systems, premises and personnel of service providers relating to the outsourced tasks.
  - Principle 7: include written provisions relating to the termination of outsourced tasks in its contract with service providers and ensure that it maintains appropriate exit strategies.

3. Next steps

- The deadline for submitting comments is the **1st of October 2020**.

04/06/2020
Statement on Importance of Disclosure about COVID-19

1. Context

The outbreak of COVID-19 has dramatically affected global economic activity since early 2020 and has required the mitigation measures to be taken such as the liquidity facilities for firms (e.g. loan payment deferral, public guarantees schemes, etc.). In response to the current uncertainty resulting from the COVID-19 pandemic, the International Organization of Securities Commissions (IOSCO) remain fully committed to the development, consistent application and enforcement of high quality reporting standards and disclosure regulations, which are of critical importance to the proper functioning of the capital markets.

In this context, the IOSCO has published a **Statement on Importance of Disclosure about COVID-19** which seeks to ensure that investors and other stakeholders have the timely and high quality financial information that they need, along with transparent and entity-specific disclosures, including information about the impact of COVID-19 on the issuer's operating performance, financial position, liquidity, and future prospects.

2. Main points

- **Impact on amounts recognized, measured and presented in the financial statements**. IOSCO reminds issuers of their responsibility to use the best available information in making well-reasoned and supported judgements and estimates that take in account the impacts of the COVID-19 pandemic, the guidance issued by standard setters and the government relief and support measures available in each jurisdiction, even if is difficult to prepare these financial statements in the evolving and uncertain environment that we are in. In addition, IOSCO expects that the issuers utilize appropriate skills and competencies in areas such as fair value measurement and impairment assessments and consider to hire the necessary experts in order to comply correctly with their obligations.
- **Importance of transparent and complete disclosures**. IOSCO notes that it is important that financial reporting include disclosures that provide an adequate level of transparency and is entity-specific regarding uncertainties inherent in judgments and estimates. IOSCO stablishes that issuers should not limit disclosures to boilerplate discussion on COVID-19 itself, but to explain:
    - How COVID-19 impacted and/or is expected to impact the <u>financial performance, financial position and cash flows of the issuer</u>.
    - How the <u>strategy and targets</u> of the issuers have been <u>modified</u> to address the effects of COVID-19.
    - Measures taken to <u>address and mitigate the impacts</u> of the pandemic on the issuer.

  Furthermore, the areas that may involve significant judgements and estimates in light of COVID-19, and thus need greater transparency in disclosures are:
    - Assessment of the <u>impact</u> of COVID-19 on the <u>historical financial information and nonfinancial information</u>.
    - Going concern <u>assessments</u>, including <u>management's plans to mitigate the uncertainty</u>.
    - Significant <u>judgements and estimates</u> regarding the <u>assessment of goodwill</u> and other nonfinancial assets for impairment, the <u>fair value measurements</u> using significant unobservable inputs and the <u>impairment of financial assets</u> including application of accounting for Expected Credit Loss (ECL).
    - <u>Forward looking information</u> may be needed in these areas to <u>project future cash flow or earnings scenario analysis</u>.
    - <u>Subsequent events</u>.
- **Non-GAAP financial measures**. IOSCO reminds issuers to be mindful of the elements of reliable and informative non-GAAP financial measures that are not potentially misleading so, given the uncertainty in the current environment, issuers should carefully evaluate the appropriateness of an adjustment or alternative profit measure. It could be misleading to describe an adjustment as COVID-19 related, if management does not explain how an adjusted amount was specifically associated with COVID-19 (e.g. characterizing an impairment as COVID-19 related despite their indicators of impairment existed prior to the pandemic or because it was based on hypothetical sales and/or profit measures)

2. Main points (cont.)

- **Interim reports**. Issuers also are reminded that interim financial reporting is intended to provide an update focusing on changes in the entity's financial position and results of operations since the last annual period. Although these interim reports usually contain fewer required disclosures than annual reports, but it will be relevant to include more detailed disclosure as well as their material effect on the issuer in the first interim report to be published since the COVID-19 pandemic.
- **Implications for the annual audit**. Given the uncertainties resulting from the COVID-19 pandemic, investors and other stakeholders may rely even more than normal on the opinion and additional information provided by auditors. IOSCO reminds external auditors of their responsibility to communicate with management and audit committees and to evaluate the adequacy and transparency of disclosures provided in the financial statements.
- **Filing deadlines extended in many jurisdictions**. The regulators in some jurisdictions have provided an accommodation that allows issuers an extended period to prepare and issue their financial information. When considering such extensions, issuers should balance the needs of investors with the responsibility for providing timely and comprehensive financial information that includes reasonable and supportable judgements, and on the other hand investors and other stakeholders are expected to pay more attention to issuers' situation. Finally, issuers should consider informing the market about the reasons for the delay, how the matters will be addressed and the expected reporting date.
- **IOSCO interaction with other stakeholders**. IOSCO will continue to collaborate with international standard setting bodies as well as other regulators, and remain fully committed to supporting the provision of high quality financial information to investors especially in the time of uncertainty resulting from the disruption of the COVID-19.

03/04/2020

Accounting for expected credit losses applying IFRS 9 Financial Instruments in the light of current uncertainty resulting from the covid-19 pandemic

1. Context

In January 2018 the international accounting standard IFRS 9 entered into force and introduced changes in credit loss provisioning by moving from an incurred loss model (under IAS 39) to an expected credit loss (ECL). IFRS 9 requires that lifetime ECLs be recognised when there is a significant increase in credit risk (SICR) on a financial instrument. However, it does not set bright lines or a mechanistic approach to determining when lifetime losses are required to be recognised. Both the assessment of SICRs and the measurement of ECLs are required to be based on reasonable and supportable information that is available to an entity without undue cost or effort. The pandemic situation caused by COVID-19 has led to an abrupt increase in uncertainty that can threaten both economic growth and financial stability, and has also resulted in issues regarding the application of IFRS 9. In the EU, for example, the European Central Bank (ECB) has recommended banks to avoid pro-cyclical assumptions in their models for determining provisions under IFRS 9 and that those who have not done this so far opt for the IFRS 9 transitional rules.

In this context, the IFRS has published a guidance document on **accounting for expected credit losses applying IFRS 9 Financial Instruments in the light of current uncertainty resulting from the COVID-19 pandemic**.

2. Main points

- **Entities should not continue to apply their existing ECL methodology mechanically**. Although current circumstances are difficult and create high levels of uncertainty, if ECL estimates are based on reasonable and supportable information and IFRS 9 is not applied mechanistically, useful information can be provided about ECLs.
- **Effects of COVID-19 and the government measures**. Entities are required to develop estimates based on the best available information about past events, current conditions and forecasts of economic conditions. In assessing forecast conditions, consideration should be given both to the effects of covid-19 and the significant government support measures being undertaken.
- **Macroeconomic scenarios**. It is likely to be difficult at this time to incorporate the specific effects of COVID-19 and government support measures on a reasonable and supportable basis. However, changes in economic conditions should be reflected in macroeconomic scenarios applied by entities and in their weightings. If the effects of COVID-19 cannot be reflected in models, post-model overlays or adjustments will need to be considered. The environment is subject to rapid change and updated facts and circumstances should continue to be monitored as new information becomes available.

3. Next steps

- The IFRS **will continue to collaborate** with prudential and securities regulators regarding the application of IFRS 9 in the context of the COVID-19 pandemic.

20/04/2020

- **Phase 2 of the Interest Rate Benchmark Reform. Proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16**
- **Snapshot: Interest Rate Benchmark Reform – Phase 2**

1. Context

In September 2019 the IASB published Phase 1 of the Interest Rate Benchmark Reform which amended IFRS 9, IAS 39 and IFRS 7. The amendments proposed on Phase 1 provide temporary exceptions to specific hedge accounting requirements, and as result, entities would apply those specific hedge accounting requirements assuming the interest rate benchmark on which the hedged risk and/or cash flows of the hedged item or of the hedging instrument are based is not altered as a result of interest rate benchmark reform.

In this context, the IASB has published the **Phase 2 of the Interest Rate Benchmark Reform, with proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16,** with the aim to assist entities with providing useful information to users of financial statements and to support preparers in applying IFRS Standards when changes are made to contractual cash flows or hedging relationships, as a result of the transition to alternative benchmark rates. In particular, this Exposure Draft proposes amendments to specific requirements relating to: i) modifications of financial assets and financial liabilities, including lease liabilities; ii) hedge accounting; iii) disclosures; and iv) risk components.

2. Main points

- **Modifications of financial assets and financial liabilities and lease liabilities**.
  - <u>Main issue</u>: applying IFRS 9, a company assesses whether a modification of a financial asset or financial liability results in derecognition of the financial asset or financial liability. If it does not result in derecognition, a modification gain or loss is determined by recalculating the carrying amount of the financial instrument using the original effective interest rate (EIR) to discount the modified cash flows.
  - <u>Proposal of the IASB</u>:
    - A **practical expedient for modifications** required by the reform, a company would not derecognize financial asset or financial liability. Modifications required by the reform would be accounted for by updating the EIR to reflect, for example, the change in an investment rate benchmark from IBOR to an alternative benchmark rate. Then, it would separately assess modifications not required by the reform to determine if they result in derecognition of a financial instrument.
    - Amendments to **IFRS 4** and **IFRS 16** to require insurers and lessees, respectively, to use the practical expedient or a similar required by the reform.
- **Hedge accounting**.
  - <u>Main issue</u>: generally, under both IFRS 9 and IAS 39, amending the formal designation of a hedging relationship would result in discontinuing the hedging relationship but discontinuing hedge accounting solely due to changes required by the reform, but this would not reflect the economic effects of the changes and would not provide useful information to investors.
  - <u>Proposal of the IASB</u>:
    - Amending **hedge accounting requirements** so that changes would not result in discontinuation of hedge accounting, and further, its amended hedging relationships would still be required to meet all other qualifying criteria.
    - For the purposes of the **IAS 39 retrospective assessment** of hedge effectiveness, requiring a company to reset the cumulative fair value changes of the hedged item and hedging instrument to zero immediately after ceasing to apply the Phase 1 relief.
- **Risk components**.
  - <u>Main issue</u>: a company may designate an item in its entirety or a component of an item as a hedged item in a hedging relationship. Both, IFRS 9 and IAS 39 require a risk component (or a portion) to be separately identifiable to be eligible for hedge accounting. When hedging relationships are amended as a result of the reform or new hedging relationships are designated, an alternative benchmark rate designated as a non-contractually specified risk component may not meet the "separately identifiable requirement".
  - <u>Proposal of the IASB</u>: an alternative benchmark rate be deemed a separately identifiable risk component if a company reasonably expects it to meet the separately identifiable requirement within 24 months of the date it is designated as a non-contractually specified risk component.

2. Main points (cont.)

- **Disclosures**.
    - Main issue: although companies are required to provide some information about the reform when applying disclosure requirements such as those in IFRS 7, some useful information may not be captured by current disclosure requirements.
    - Proposal of the IASB: requiring companies to make additional disclosures in its financial statements so that investors can better understand the reform's effects on that company.

3. Next steps

- Comments to this proposal should be submitted by **25 May 2020**.
- These amendments would apply for an annual reporting periods beginning on or after **1 January 2021**, though earlier application would be permitted.

04/05/2020
Expousure draft COVID-19 Related Rent Concessions Proposed amendment to IFRS 16

1. Context

IFRS 16 Leases contains requirements that specify the accounting for changes in lease payments, including rent concessions. This standard contains specific requirements for some changes in lease payments to determinate if they pose a lease modification and, as a result, it requires an reassessment regarding IFRS 16. The COVID-19 disruption may cause an increase of applying potentially large volume of rent concessions. Consequently, lessees have identified potential difficulties in the current environment in assessing whether COVID-19 related rent concessions are lease modifications and, for those that are, applying the required accounting.

In this context, the IASB has published the **Exposure draft of COVID-19-Related Rent Concessions Proposed amendment to IFRS 16** with the aim to provide lessees of a lease agreement with practical relief during the covid-19 pandemic while enabling them to continue providing useful information about their leases to users of financial statements.

2. Main points

- **Scope of application**. The proposal in this Exposure Draft would affect lessees of the lease agreement that are granted rent concessions as a direct consequence of the COVID-19 pandemic during 2020, and users of these lessees' financial statements. It does not apply for lessors.
- **Rent concessions accounting**. The Exposure draft permits lessees, as a practical expedient, account for those rent concessions as if they were not lease modifications. However, the lessee could apply the practical expedient, as long as all the following requirements was complied:
    - Rent concessions must occur as a direct consequence of the COVID-19 pandemic.
    - Changes in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change.
    - Reductions in lease payments affects only payments originally due in 2020.
    - There is no substantive change to other terms and conditions of the lease.
- **Modifications of financial statements**. If a lessee grants a rent concessions is required to apply the disclosure requirements and reflect the changes in the financial statements about the leasing activities. There are three types of change:
    - Forgiveness or waiver of lease payments and adjusting the financial statements derecognising the part of the lease liability that has been extinguished by the forgiveness or waiver of lease payments.
    - Change on the timing payment by reducing payments in one period but proportionally increases payments in another. This does not extinguish the lessee's lease liability or change the consideration for the lease.
    - Some COVID-19 related rent concessions reduce lease payments, incorporating both a forgiveness of payments and a change in the timing of payments.
- **Transition and effective date**. The draft amendments to IFRS 16 propose that a lessee would apply the amendment:
    - For annual reporting periods beginning on or after 1 June 2020. Earlier application is permitted, including in financial statements not yet authorised for issue at the date the amendment is issued.
    - Retrospectively, recognising the cumulative effect of initially applying the amendment as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the beginning of the annual reporting period in which the lessee first applies the amendment.

3. Next steps

- It has opened a term to submit comments about this draft until **8 May 2020**.
- The IASB plans to complete any resulting amendment to IFRS 16 by the end of **May 2020**.

04/05/2020

Decision to launch a New Short-Term Liquidity Line to Enhance The Adequacy Of The Global Financial Safety Net

1. Context

In 2017, the IMF proposed the creation of a new facility to provide liquidity support to the IMF's membership, called the Short-term Liquidity Swap (SLS). The SLS was designed as a response to a critical gap highlighted by the Fund's work on the Adequacy of the Global Financial Safety Net (GFSN), particularly the lack of predictable and reliable funding for many countries, including systemic and gatekeeper countries. While the SLS did not garner the required support to be adopted in 2017, many IMF Directors noted that this type of facility could be an important addition to the IMF lending toolkit, and that several of the proposed features could act as a blueprint for future IMF instruments.

In the context of intensified demand for liquidity and heightened global uncertainty due to the COVID-19 outbreak, the IMF has published a decision to create a **New Short-Term Liquidity Line to Enhance The Adequacy Of The Global Financial Safety Net**, based on the key features of the 2017 blueprint as a consequence of the need to move quickly in response to the COVID-19 crisis.

2. Main points

- **Objective and eligibility to access the SLL**. The SLL aims to reduce the impact of liquidity events and minimize the risk of shocks evolving into deeper crises and generating spillovers to other countries. The SLL is a special facility which provides liquidity support for members facing potential short-term moderate balance of payments difficulties, defining these as:
    - Only of a potential nature, reflected in pressure on the capital account and the member's reserves.
    - Resulting from volatility in international capital markets.
    - Reasonably expected to be limited in scale and to require, at most, fine-tuning of monetary and exchange rate policies.

  According to be eligible, the member shall:
    - Has very strong economic fundamentals and institutional policy frameworks.
    - Is implementing and has a sustained track record of implementing very strong policies.
    - Remains committed to maintaining such policies in the future.
- **Main characteristics of the SLL arrangements**:
    - May be approved in an amount of <u>up to 145 percent of the member's quota</u>, with this limit being cumulative for total credit outstanding under the SLL.
    - Shall be approved for a period of <u>12 months</u> and shall expire only upon the earlier of:
        - The **expiration of the approved period** of the arrangement.
        - The **cancellation** of the SLL arrangement by the member.

  A member shall be obliged to repurchase any amounts purchased under an SLL arrangement no later than <u>12 months after the date of the purchase of such amounts</u>.
- **SLL process**. The proposed process for the approval and use of an SLL arrangement largely follows the process for Flexible Credit Line (FCL) arrangements with two notable differences: the extension of an "offer" by the Fund to those members that qualify, and the absence of a prior informal Board meeting. The main steps of SLL process are:
    - Initial <u>confidential consultation</u> and assessment of qualification.
    - Preparation of the Board paper and formal <u>IMF meeting to consider the case for an offer</u> and conditional approval of an arrangement.
    - <u>Communication of the Board's conditional approval of the arrangement to the authorities</u> who must respond within two weeks from the date of the conditional approval.
    - Once the arrangement is approved and becomes effective, members could make <u>one or multiple purchases during the period of the SLL arrangement</u> subject to the approved access level.

3. Next steps

- The SLL will be **reviewed in 2022** as part of the regular review of the FCL and Precautionary and Liquidity Line (PLL).
- The SLL shall **terminate seven years after the date of adoption of this decision**, with the possibility of an extension regarding the Executive Board agreement by end-2025.

01/06/2020
MREL Policy under the Banking Package

1. Context

In October 2019, the EP and the Council published in the OJEU a reform package of the banking system, which introduces amendments included to the Capital Requirement Directive (CRD IV), the Capital Requirement Regulation (CRR), the Bank Recovery and Resolution Directive (BRRD), the Single Resolution Mechanism Regulation (SRMR), and the Regulation on EMIR.

In this context, the SRB has published **Minimum Requirements for Own Funds and Eligible Liabilities (MREL) Policy under the Banking Package** with aim of the adaptation of MREL requirements to the new framework to ensure that banks maintain a minimum amount of equity and debt to support an effective resolution in line with the new banking package (BRRD2/SRMR2/CRR2/CRDV). The SRB's provisions aim to ensure that MREL is set in the context of fully feasible and credible resolution plans, for all types of banks and to promote a level playing field across banks including for Banking Union subsidiaries of non-banking Union (EU) banks.

2. Main points

- **Calibration**. The SRB is modifying and extending its approach to MREL calibration in accordance with the new framework.
  - The Banking Package introduced the total loss-absorbing capacity (TLAC) minimum requirement for global systemically important institutions (GSIIs), from the global standards set by the Financial Stability Board (FSB), and adapted the current MREL framework accordingly.
  - Although the initial implementation of the leverage ratio was planned for 1 January 2022, the Basel Committee on Banking Supervision (BCBS) has postponed it until 2023 as a measure of flexibility due to the impact of COVID-19. From this date, CRR will require institutions to comply with a prudential leverage ratio requirement at all times, acting as a backstop to risk-based own funds requirements and the revised BRRD introduces an MREL requirement based on the Leverage Ratio Exposure Measure (LRE) to complement the risk-based MREL expressed as a percentage of the total risk exposure amount (TREA).
  - MREL is composed of a loss-absorption amount (LAA) and a recapitalisation amount (RCA). New provisions define conditions under which the RCA may be adjusted upwards or downwards.
  - MREL for banking groups with a Multiple Point of Entry (MPE) approach to resolution has been further refined. If MPE is the preferred resolution strategy, the MRELs for the different resolution groups (i.e. the points of entry) should be set in such a way that each can be resolved independently without causing immediate shortfalls in other resolution groups.
- **Subordination for Resolution entities**. The SRB sets subordination requirements in accordance with the new framework, as well as defining a methodology to determine and quantify no creditor worse off (NCWO) risk. Specifically:
  - Pillar 1 Banks includes: (i) resolution entities of G-SIIs and material subsidiaries of non-EU G-SIIs; (ii) banks with total assets exceeding EUR 100bn at the level of the resolution group (Top Tier Banks); and (iii) other banks chosen by the respective national resolution authority (NRA) which are not Top Tier Banks but are assessed as likely to pose a systemic risk in the event of failure (Other Pillar 1 Banks).
  - Pillar 1 Banks' resolution authority must ensure that the subordinated MREL resources of Pillar 1 Banks are equal to at least 8% of total liabilities and own funds (TLOF). The resolution authority may reduce or increase this target level of minimum subordination for Pillar 1 Banks on a case by case basis and subject to conditions. When setting the subordinated component of the MREL ensuring the 8% TLOF target, the resolution authority shall count CET1 eligible for capital buffers towards the 8% target.
  - Non Pillar 1 banks will be subject to a subordination requirement only upon the decision of the resolution authority to avoid a breach of the NCWO principle, following a bank-specific assessment carried out as part of resolution planning.
  - The SRB has developed a valuation-based tool to quantify possible NCWO risk. Assessing the need for subordination depends on projections of the size and distribution of losses for different classes of creditors under different strategies and conditions. The quantitative tool provides such projections by combining accounting and historical market data.

2. Main points (cont.)

- **Internal MREL for non-resolution entities**. The SRB will progressively expand the scope of non-resolution entities for which it will adopt internal MREL decisions. Coverage will encompass entities providing critical functions and/or those meeting the 4% threshold of the resolution group's total risk exposure amount, or leverage exposure, or total operating income (the previous threshold was 5%). The SRB may waive subsidiary institutions qualifying as non-resolution entities from internal MREL following the next criteria:
  - If the subsidiary and its resolution entity (or its parent undertaking) are established in the same Member State and are part of the same resolution group.
  - If the resolution entity (or its parent undertaking) complies with the requirement referred in SRMR (i.e. consolidated external MREL on a consolidated basis at the level of the resolution group) or respectively MREL at sub-consolidated level.
  - If there is no current or foreseen material, practical, or legal impediment to the transfer of funds by the resolution entity to the subsidiary, in particular when resolution action is taken in respect of the resolution entity or the parent undertaking.

  The SRMR grants the SRB the possibility to permit the use of guarantees to meet the internal MREL within the Member State of the resolution entity.
- **MREL for cooperation groups**. The SRB sets out minimum conditions to authorise certain types of cooperative networks to use eligible liabilities of associated entities other than the resolution entity to comply with the external MREL, as well as minimum conditions to waive the internal MREL of the legal entities that are part of the cooperative network. The specific criteria for the MREL treatment of cooperative networks are:
  - Own funds issued by any of the entities are capable of absorbing losses to restore the solvency of any of the entities of the resolution group.
  - Eligible liabilities issued by any of the network entities would be subject to bail-in, under the resolution strategy relevant for MREL setting, in case any of these entities reaches the point of failing or likely to fail (FOLTF).
  - There is no material risk of breaching the NCWO principle with a clear ranking on distribution of losses within the group. In particular, NCWO should be respected when applying the bail-in tool on a pro-rata basis to network eligible liabilities that are part of the same class in the creditor hierarchy.
  - Appropriate communication to investors investing in MREL eligible debt instruments and information about the potential bail-in of such instruments for the recapitalisation of any of the entities of the network has taken place.
  - Determination of the FOLTF criteria is on a joint basis: the SRB will consider the likelihood of a FOLTF criteria determination being made at the level of all affiliated entities of the network and the central body, either simultaneously or as a whole at group level, taking into account as well the possible assessment of the conditions for resolution for cooperative networks under BRRD that are part of the same resolution group.
  - Regarding the waiver from individual targets (internal MREL), the SRMR introduces six criteria for granting affiliated credit institutions, or the central body itself, this waiver with flexibility offered to the SRB when assessing the criteria on any impediment to the prompt transfer of own funds or repayment of liabilities. This assessment is based on an analysis of the bilateral relation between the central body and the respective affiliated institution.
- **Eligibility of liabilities is issued under the law of a third country**. Requires that the legal system of that country recognises that an EU resolution authority can modify those liabilities. In the absence of a cross-border recognition framework, recognition might be achieved through prior contractual acceptance by creditors that their contractual claims may be cancelled or modified in resolution. In line with BRRD requires institutions to include a contractual clause in contracts by which the creditor or party to the agreement creating the liability recognises that the liability may be subject to the write-down and conversion powers of an EU resolution authority.

3. Next steps

- The deadline of meeting external and internal MREL, including subordination requirements, is in **1 January 2024**.
- From now until 1 January 2024, two intermediate targets will be established: a first binding intermediate target to be met by **1 January 2022** and a second intermediate target of an informative nature for **1 January 2023**; both to ensure the compliance of the Planned minimum requirements which are defined for each 12-month period.

11/05/2020
Coronavirus response: Banking Package to facilitate bank lending- Supporting households and businesses in the EU

1. Context

The disruption of COVID-19 has caused the adoption of measures for local and supranational agencies to mitigate the economic impact from this pandemic. In order to achieve this goal, Europa has posed measures such as a new temporary asset purchase programme of private and public sector securities (called the Pandemic Emergency Purchase Programme) or supervisory flexibility regarding the treatment of non-performing loans (NPLs) from European Central Bank (ECB) and the explanation based on how to make best use of the flexibility provided for in the existing prudential and accounting regulatory framework.

In this context, the EC has published a **banking package in response to coronavirus, to facilitate bank lending and supporting households and businesses in the EU**. This package is intended to encourage banks to make full use of the flexibility embedded in the EU's prudential and accounting framework, so that banks can fully support citizens and companies during this pandemic by providing funding.

2. Main points

- **Flexibility in EU's banking rules**. This document states that some of the prudential and accounting rules can be used more flexibly during the pandemic so that banks can focus on lending to households and companies. In particular, the areas of flexibility in the EU's regulatory framework include:
    - The rules on how banks assess the risk that a borrower will not repay a loan in a sudden economic crisis, such as the coronavirus pandemic, and the effect that has on the amount of money the bank needs to set aside for any possible losses.
    - The prudential rules on the classification of non-performing loans (NPLs) in the context where relief measures such as guarantee schemes and moratoria have been provided either by Member States or by banks.
    - The accounting treatment of delays in the repayment of loans.

  In addition, this IC clarifies rules regarding:
    - IFRS 9 flexibility. This document clarifies the flexibility available in IFRS 9 and explains how that can maintain the flow of liquidity to EU households and businesses:
        - **The Expected Credit Loss (ECL) approach under IFRS 9**. If households or businesses are temporary unable to pay back their loans because of the coronavirus pandemic, banks do not have to automatically increase their ECL provisions. IFRS 9 leaves it to banks to use their own judgment when determining if expected credit losses are required to be recognised.
        - **The Assessment of a "Significant Increase in Credit Risk" (SICR)** should be based on the remaining lifetime of a loan and not just on the sudden increase in the probability of default caused by the coronavirus pandemic.
        - **Use of moratoria and SICR**. Loans should not automatically be considered to have suffered a SICR simply because they have become subject to private or statutory moratoria.
    - NPLs. This IC clarifies how the prudential rules on the classification of NPLs can accommodate the flexibility measures such as more favourable treatment of publicly guaranteed loans or payment moratoria.
    - Digital payments. The EC encourages banks to promote digital banking, while at the same time, remaining alert and continuing to fight financial crime, which is likely to increase in the context of the pandemic.

2. Main points (cont.)

- **Legislative proposals**. In order to maximize the ability of EU banks to lend during the Coronavirus pandemic, while also ensuring their continued resilience, the EC has proposed exceptional temporary regulation changes. In this regard, the following changes to Capital Requirements Regulation (CRR) have been proposed:
  - Basel III: transitional arrangements for mitigating the impact of IFRS 9 provisions on regulatory capital. To mitigate the potential negative impact of the potential increase in the ECL according to IFRS 9 application, the EC has proposed an extension of the current transitional arrangements in the CRR by two years, to allow banks to add back to their regulatory capital any increase in new expected credit losses provisions that they recognise in 2020 and 2021 for their financial assets, which have not defaulted. To ensure that the additional relief is related to the exceptional circumstances of the Coronavirus pandemic, only provisions incurred as of 1 January 2020 would be eligible.
  - Basel III: date of application of the leverage ratio buffer. The date of application of the new leverage ratio buffer is proposed to be deferred by one year to 1 January 2023.
  - More favourable treatment of publicly guaranteed loans under the NPL prudential backstop. It is proposed to temporarily extend the preferential treatment of NPL guaranteed by official export credit agencies to NPLs guaranteed by the public sector.
  - Changes in the calculation of leverage ratio. CRR provides an offsetting mechanism to temporarily exclude central bank reserves from a bank's leverage ratio calculation in exceptional circumstances. The proposal is to modify the offsetting mechanism enabling banks to calculate adjusted leverage ratio only one at the moment which the discretion is exercised .The aim is not force banks to deleverage by selling assets or reducing the level of lending to the real economy.
  - Finally, it is brought forward the proposed date of application of: the exemption of certain software assets from capital deductions, the specific treatment envisaged for certain loans backed by pensions or salaries, and the revised small and medium enterprises (SME) supporting factor and the new infrastructure supporting factor.

3. Next steps

- The EC **will monitor the implementation** of the IC in close cooperation with the ECB-SSM and national competent authorities (NCAs).
- The legislative proposals will be discussed by the European Parliament and the Council, hoping to be adopted in June due to the urgency in mitigation of COVID-19 effects.

27/04/2020
First reading position on the taxonomy of sustainable activities

1. Context

In March 2018, the European Commission (EC) published its Action Plan on Financing Sustainable Growth which set out a comprehensive strategy to further connect finance with sustainability. In Action 2 of the Action Plan, the EC committed to create standards and labels for green financial products. In June 2018, the EC set up the Technical Expert Group on sustainable finance (TEG) to assist it in developing the EU taxonomy to determine whether an economic activity is environmentally sustainable; an EU Green Bond Standard (GBS); methodologies for EU climate benchmarks and disclosures for benchmarks; and guidance to improve corporate disclosure of climate-related information.

In this context, the Council has published the **First reading position on the taxonomy of sustainable activities** which containts a common EU-wide classification system which will provide businesses and investors with harmonised criteria to identify economic activities that are considered environmentally sustainable in order to transition to a low-carbon, resilient and resource-efficient economy.

2. Main points

- **Scope of application**. The taxonomy will be applicable to:
    - Measures adopted by EU and Member States that set out requirements for financial market participants or issuers in respect of financial products or corporate bonds that are made available as environmentally sustainable.
    - Financial market participants offering financial products in the EU.
    - Large companies who are already required to provide a non-financial statement.
- **Environmental objectives**. The EU Taxonomy sets as environmental objectives:
    - Climate change mitigation.
    - Climate change adaptation.
    - The sustainable use and protection of water and marine resources.
    - The transition to a circular economy.
    - Pollution prevention and control.
    - The protection and restoration of biodiversity and ecosystems.
- **Environmentally sustainable economic activities**.
    - Criteria. For the purposes of establishing the degree to which an investment is environmentally sustainable, an economic activity shall qualify as environmentally sustainable where that economic activity:
        - **Contributes substantially** to one or more of the environmental objectives.
        - **Does not significantly harm** any of the environmental objectives.
        - Is carried out in compliance with the **minimum safeguards** set out in the OECD guidelines and the un guiding principles.
        - Complies with **technical screening criteria**.
    - Transparency regarding:
        - **Environmentally sustainable investments** in pre-contractual disclosures and in periodic reports.
        - **Financial products that promote environmental characteristics** in pre-contractual disclosures and in periodic reports.
        - **Other financial products** in pre-contractual disclosures and in periodic reports.
        - **Undertakings** in non-financial statements.

3. Next steps

- The taxonomy for climate change mitigation and climate change adaptation should be established by the **end of 2020** in order to ensure its full application by end of 2021.
- For the four other objectives, the taxonomy should be established by the **end of 2021** for application by the end of 2022.

EUROPEAN CENTRAL BANK
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20/04/2020
Package of temporary collateral easing measures

1. Context

Since the beginning of March, various agencies at both the local and supranational levels have begun to issue measures to mitigate the possible impact that the COVID-19 could have on the economy. In Europe, the ECB has launched a new temporary asset purchase programme of private and public sector securities called the Pandemic Emergency Purchase Programme (PEPP) of €750 billion as well as an additional longer-term refinancing operations (LTROs), and it allow banks to temporarily operate below Pillar 2 Guidance (P2G), the capital conservation buffer (CCB) and the liquidity coverage ratio (LCR) requirement. Furthermore, the European Banking Authority (EBA) has decided to postpone the EU-wide stress test exercise to 2021 and it will carry out an additional EU-wide transparency exercise in 2020. In addition, the ECB has introduced supervisory flexibility regarding the treatment of non-performing loans (NPLs), recommended banks to avoid procyclical assumptions in their models to determine provisions on IFRS 9 and postpone some inspections.

In this context, the ECB has published a **package of temporary collateral easing measures** in order to mitigate the tightening of financial conditions across the euro area. These measures along with the previously taken support the provision of bank lending especially by easing the conditions at which credit claims are accepted as collateral. At the same time the Eurosystem is increasing its risk tolerance to support the provision of credit via its refinancing operations, particularly by lowering collateral valuation haircuts for all assets consistently.

2. Main points

- **Collateral measures**. The ECB decided on a set of collateral measures to facilitate an increase in bank funding against loans to corporates and households. This will be achieved by expanding the use of credit claims as collateral, in particular through the potential expansion of the additional credit claims (ACCs) frameworks. In this respect, the ECB decided to temporarily extend the ACC frameworks further by:
    - Accommodating the requirements on guarantees to include government and public sector guaranteed loans to corporates, SMEs and self-employed individuals and households in the ACC frameworks in order to also provide liquidity against loans benefiting from the new guarantee schemes adopted in euro area Member States as a response to the coronavirus pandemic.
    - Enlarging the scope of acceptable credit assessment systems used in the ACC frameworks (e.g. by easing the acceptance of banks' own credit assessments from internal rating-based systems that are approved by supervisors).
    - Reducing the ACC loan level reporting requirements to allow counterparties to benefit from the ACC frameworks even before the necessary reporting infrastructure is put in place.
- **Temporary measures**.
    - A lowering of the level of the non-uniform minimum size threshold for domestic credit claims to EUR 0 from EUR 25,000 previously to facilitate the mobilisation as collateral of loans from small corporate entities.
    - An increase, from 2.5% to 10%, in the maximum share of unsecured debt instruments issued by any single other banking group in a credit institution's collateral pool. This will enable counterparties to benefit from a larger share of such assets.
    - A waiver of the minimum credit quality requirement for marketable debt instruments issued by the Hellenic Republic for acceptance as collateral in Eurosystem credit operations.
- **Risk tolerance level**. The ECB decided to temporarily increase its risk tolerance level in credit operations through a general reduction of collateral valuation haircuts by a fixed factor of 20%. This adjustment aims to contribute to the collateral easing measures while maintaining a consistent degree of protection across collateral asset types, albeit at a temporarily lower level.
- **Haircuts**. The ECB decided to adjust the haircuts applied to non-marketable assets, both in the general collateral framework and for ACCs, by fine-tuning some of the haircut parameters. This adjustment, which is not linked to the duration of the PEPP, applies in addition to the temporary haircut reduction and thus further supports the collateral easing measures while maintaining adequate risk protection. This leads on average to a further haircut reduction of this type of collateral by around 20%.

3. Next steps

- These measures, except for the haircut adjustment applicable to non-marketable assets, are temporary for the duration of the pandemic crisis and linked to the duration of the PEPP. They will be **re-assessed before the end of 2020**, also considering whether there is a need to extend some of these measures to ensure that Eurosystem counterparties' participation in its liquidity providing operations is not adversely affected.

27/04/2020
Temporary measures to mitigate impact of possible rating downgrades on collateral availability

1. Context

On 7 April, ECB adopted a package of temporary collateral easing measures in order to mitigate the tightening of financial conditions across the euro area due to the economic impact of COVID-19. These measures ease the conditions at which credit claims are accepted as collateral and, as a result, making the granting loans more flexible. In order to achieve this goal, the Eurosystem is also increasing its risk tolerance to support the provision of credit via its refinancing operations, adopting measures such as lowering collateral valuation haircuts for all assets consistently.

In this context, the ECB has published **Temporary measures to mitigate impact of possible rating downgrades on collateral availability** which complements the broader collateral easing package that was announced on April. These measures aim to ensure that banks have sufficient assets that they can mobilise as collateral with the Eurosystem to participate in the liquidity-providing operations and to continue providing funding to the euro area economy.

2. Main points

- **Eligibility of marketable assets used as collateral**. Marketable assets and issuers of these assets that met the minimum credit quality requirements for collateral eligibility on 7 April 2020 (i.e. BBB- for all assets, except asset-backed securities (ABSs)) will continue to be eligible in case of rating downgrades, as long as their rating remains at or above credit quality step 5 (CQS5), which is equivalent to a rating of BB, on the Eurosystem harmonised rating scale. This ensures that assets and issuers that were investment grade at the time the ECB adopted the package of collateral easing measures remain eligible even if their rating falls two notches below the current minimum credit quality requirement of the Eurosystem. This temporary measures will have the following characteristics:
    - To be grandfathered, the assets need to continue to fulfil all other existing collateral eligibility criteria.
    - Future issuances from grandfathered issuers will also be eligible provided they fulfil all other collateral eligibility criteria.
    - Currently eligible covered bond programmes will also be grandfathered, under the same conditions.
    - Currently eligible ABSs to which a rating threshold in the general framework of CQS2 applies (equivalent to a rating of A-) will be grandfathered as long as their rating remains at or above CQS4 (equivalent to a rating of BB+).
    - Assets that fall below the minimum credit quality requirements will be subject to haircuts based on their actual ratings.

3. Next steps

- These measures will apply until **September 2021** when the first early repayment of the third series of targeted longer-term refinancing operations (TLTRO-III) takes place.

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11/05/2020
Alternative scenarios for the impact of the COVID-19 pandemic on economic activity in the euro area

1. Context
COVID-19 pandemic has dramatically affected global economic activity since early 2020. The rapid spread of the coronavirus (COVID-19) has required drastic measures to be taken such as social distancing, stopping of economic activity and the banning of public events to shutdowns. The containment measures are being lift gradually by national authorities, however, they could still be in force for some time. Consequently, these measures have weighed on supply and have also induced households and firms to retrench their spending, thereby reducing aggregate demand. In addition, widespread closures of firms have triggered a marked deterioration in employment conditions and an increase in firms' liquidity needs.

In this context, the ECB has published a set of **Alternative scenarios for the impact of the COVID-19 pandemic on economic activity in the euro area** to illustrate, through a scenario analysis, the high uncertainties surrounding the developments of the pandemic, the need for and effectiveness of containment measures, and the possible emergence of medical treatments and solutions. In particular, three scenarios are analysed and they vary according to a number of factors, namely: i) the duration of the strict lockdown measures and their impact on sectoral economic activity; ii) the economic effects of protracted containment measures during a post-lockdown transition period; iii) the behavioural responses by economic agents to minimise economic disruptions, and iv) the longer-lasting effects for economic activity once all containment measures have been lifted.

2. Main points

- **Mild scenario**. This scenario presumes a strict lockdown and further containment measures, as well as rapid advances in medical treatments, which entail relatively short-lived strict lockdown period (ending in the course of May 2020), a gradual return to normal activity thereafter and only temporary economic losses. The economic impact of the COVID-19 pandemic expected by this scenario consist on the following:
    - Euro area foreign demand will fall by around 7%.
    - Real GDP will plummet by around 5% in 2020.
    - As containment measures allow for a gradual normalisation of economic activity, real GDP is expected to increase by around 6% in 2021.
- **Medium scenario**. This scenario presumes a short-lived strict lockdown period (also ending in the course of May 2020) that is followed by relatively stringent and protracted containment measures, implying a delayed return to normal activity, as well as persistent output losses. The economic impact of the COVID-19 pandemic expected by this scenario consist on the following:
    - Euro area foreign demand will fall by around 11%.
    - Real GDP will plummet by around 8% in 2020.
    - Real GDP is expected to increase by around 5% in 2021.
- **Severe scenario**. This scenario presumes a longer-term strict lockdown period (ending in the course of June 2020) that has only limited success in containing the spread of the virus, thus requiring ongoing tough containment measures to remain in place even after some loosening of the very strict lockdowns. Furthermore, the sustained efforts to prevent the spread of the virus would continue to significantly dampen activity across sectors of the economy until a vaccine (or another effective medical solution) were to become available, which is not expected to occur until around mid-2021. Finally, this scenario envisages significant and permanent output losses. The economic impact of the COVID-19 pandemic expected by this scenario consist on the following:
    - Euro area foreign demand will fall by around 19%.
    - Real GDP will plummet by around 12% in 2020.
    - Real GDP is expected to increase by around 4% in 2021.
    - Under this scenario, real GDP is expected to remain well below the level observed at the end of 2019 until the end of 2022.
- **Impacts of containment measures across economic sectors**. The collapse in activity is initially the strongest for services, particularly those related to travel and recreational activities. Overall, the containment measures are assumed to cause a relatively larger loss of value added in retail trade, transport, accommodation and food service activities (60%) compared to manufacturing (40%), construction (40%) and other sectors (e.g. financial and insurance activities (10%) or agriculture (10%)). The economic loss during the first quarter, in terms of value added in relation to the normal level of activity, is estimated at approximately 30%. It is expected that during the second quarter this impact can be adjusted depending on the country (i.e. 20% - 30%). The marginal impact of an additional month of containment measures is initially between 2% and 2.5% on annual GDP.

3. Next steps

- Regardless of the publication of alternative scenarios for the impact of the COVID-19, Eurosystem staff will carry out the **macroeconomic projections** in the euro zona in **June 2020**, not only analysing the impact on economic activities but also fully-fledged projection exercise, including a detailed assessment of the inflation outlook.

EUROPEAN CENTRAL BANK
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25/05/2020
Draft Guide on climate-related and environmental risks

1. Context

Following the adoption of the Paris Agreement on climate change and the UN 2030 Agenda for Sustainable Development in 2015, governments are making strides to transition to low-carbon and more circular economies on a global scale. In Europe, the European Green Deal sets out the objective of making Europe the first climate-neutral continent by 2050. In this sense, the financial sector is expected to play a key role and for the second year, the ECB has identified climate-related risks as a key risk driver on the SSM Risk Map for the euro area banking system.

In this context, the ECB has launched a public consultation on the **Draft ECB Guide on climate-related and environmental risks** which outlines the ECB's understanding of the safe and prudent management of climate-related and environmental risks (hereafter referred to as climate risks) under the current prudential framework, the expectations on how institutions should consider these risks – as drivers of established categories of prudential risks – when formulating and implementing their business strategy and governance and risks management frameworks, and the expectations on how institutions should become more transparent by enhancing their disclosure of information.

2. Main points

- **Scope**. The expectations set out in this guide are to be used in the ECB's supervisory dialogue with significant institutions directly supervised. However, this guide has been developed jointly by the ECB and the national competent authorities (NCAs) and therefore, NCAs are recommended to apply in substance the expectations established in this guide in their supervision of less significant institutions (LSIs), proportionately to the risk profile and business model of the institution.
- **Supervisory expectations relating to business models and strategy**. Institutions are expected is to identify, assess and monitor the current and forward-looking impact of climate-related and environmental factors on their business environment and to ensure the sustainability and resilience of their business model going forward.
- **Supervisory expectations relating to governance and risk appetite**. Institutions are expected to embed climate risks in their governance and risk appetite frameworks, while adequately involving all relevant functions. Additionally, appropriate and regular reporting on these risks to the management body is expected to ensure proper management of these risks.
- **Supervisory expectations relating to risk management**. This guide provides detailed guidance on integrating climate risks into credit, operational, market and liquidity risk management, as well as into the ICAAP, including risk quantification by means of scenario analysis and stress testing.
    - <u>Risk management framework</u>. Institutions are expected to incorporate climate risks as drivers of established risk categories into their existing risk management framework, with a view to managing and monitoring these over a sufficiently long-term horizon, and to review their arrangements on a regular basis. Furthermore, institutions are expected to identify and quantify these risks within their overall process of ensuring capital adequacy.
    - <u>Credit risk management</u>. Institutions are expected to consider climate risks at all stages of the credit-granting process and to monitor the risks in their portfolios.
    - <u>Operational risk management</u>. Institutions are expected to consider how climate-related events could have an adverse impact on business continuity and the extent to which the nature of institutions' activities could increase reputational and/or liability risks.
    - <u>Market risk management</u>. Institutions are encouraged to monitor on an ongoing basis the effect of climate-related and environmental factors on their current market risk positions and future investments, and to develop stress-testing scenarios that incorporate climate-related and environmental risks.
    - <u>Scenario analysis and stress testing</u>. Institutions with material climate risks are expected to evaluate the appropriateness of their stress testing, with a view to incorporating them into their baseline and adverse scenarios.
    - <u>Liquidity risk management</u>. Institutions are expected to assess whether material climate risks could cause net cash outflows or depletion of liquidity buffers and, if so, incorporate these factors into their liquidity risk management and liquidity buffer calibration.
- **Supervisory expectations relating to disclosures**. This guide establishes that for the purposes of their regulatory disclosures, institutions are expected to publish meaningful information and key metrics on climate risks that they deem to be material, as a minimum, in line with the European Commission's *Guidelines on non-financial reporting: Supplement on reporting climate-related information*.

3. Next steps

- Comments to this public consultation should be submitted by **September, 25 2020**.
- This Guide will be applicable as of its date of publication.

04/05/2020
Consultation Paper (CP) on proposed environmental, social and governance (ESG) disclosure standards

1. Context

Following the adoption of the 2015 Paris Agreement on climate change and the United Nations (UN) 2030 Agenda for Sustainable Development, the European Commission (EC) has expressed in the Action Plan “Financing Sustainable Growth” its intention to clarify fiduciary duties and increase transparency in the field of sustainability risks and sustainable investment opportunities. Given the environmental emergency situation, urgent action is needed to mobilise capital not only through public policies but also by means of the financial services sector. In order to adapt to this new environment, financial markets participants and financial advisers should be required to disclose specific information on their approaches to the integration of sustainability risks and the consideration of adverse sustainability impacts.

In this context, the ESAs have published the **Joint Consultation Paper on ESG disclosures standards for financial market participants, advisers and products** with the aim of seeking input to develop draft Regulatory Technical Standards (RTS) on sustainability-related disclosures in the financial services sector (SFDR) with regard to the content, methodologies and presentation of information in relation to sustainability indicators and the promotion of environmental or social characteristics and sustainable investments objectives in pre-contractual documents, websites and periodic reports.

Furthermore, a preliminary analysis of the expected impacts of the proposed draft RTS is also included in order to gather stakeholder feedback on possible costs and benefits of the proposals and the relative scale of these costs and benefits for different stakeholders.

2. Main points

- **Transparency of adverse sustainability impacts**. This draft RTS provides a specification for the content, methodology and presentation of the information in respect of the sustainability indicators in relation to adverse impacts on the climate and other environment-related adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters. In particular, this draft RTS includes the following aspects:
  - A mandatory reporting template to use for the statement on considering principal adverse impacts of investment decisions on sustainability factors, as well as the actions taken and planned to mitigate these impacts.
  - A set of indicators for both climate and environment-related adverse impacts and adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.
  - A statement to be published where adverse impacts of investment decisions are not considered by financial market participants and advisers on their websites.
  - Requirements for financial advisers in line with their obligations.
- **Pre-contractual product disclosure**. This draft RTS set out the details of the content and presentation of the information to be disclosed at the pre-contractual level in the sectoral documentation. In particular, this draft RTS includes the following aspects:
  - A requirement to use a mandatory reporting template for the presentation of pre-contractual disclosure.
  - A list of items to be included in the reporting indicating clearly the type of product and how the environmental or social characteristic (or combination thereof) or the sustainable investment objective of the product are achieved.
  - Additional items of disclosure where the product designates an index as a reference benchmark.
  - Requirements for products making sustainable investments regarding how the product complies with the *do not significantly harm* principle in relation to the principal adverse impact indicators.
- **Website product disclosure**. This draft RTS set out the details of the content and presentation of information to be publicly disclosed on the website by the financial market participant. In particular, this draft RTS includes the following aspects:
  - Set out where and how the financial market participant must publish the information on the website.
  - A list of items to be included in the disclosure, focusing on the methodology employed, the data sources used, and any screening criteria employed.
  - Requirements for products making sustainable investments regarding how the product complies with the *do not significantly harm* principle in relation to the principal adverse impact indicators.

2. Main points (cont.)

- **Public disclosure in periodic report**. This draft RTS set out the details of the content and presentation of information to be disclose. In particular, this draft RTS includes the following aspects:
    - A requirement to use a mandatory reporting template for the presentation of the periodic disclosure.
    - A list of items to be included in the reporting, focusing on the success of the product in attaining its environmental or social characteristic (or combination thereof) or sustainable investment objective.
    - Requirements for products making sustainable investments regarding how the product complies with the *do not significantly harm* principle in relation to the principal adverse impact indicators.

3. Next steps

- Comments to this CP could be submitted until **1 September 2020**.
- The final regulation shall apply from **10 March 2021**.
- Provisions regarding product disclosure in periodic reports shall apply from **1 January 2022**.

11/05/2020

Final Report on EMIR RTS on various amendments to the bilateral margin requirements in view of the international framework

1. Context

In 2016, the European Commission (EC) adopted the regulation to implement the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) international standards for the exchange of bilateral margin in the EU. In particular, this international framework contains a phase-in for the implementation of the initial margin requirements which has been spread over several years and this implementation is still ongoing. Since then, the ESAs have monitored the implementation of these requirements in the EU, and by the regulatory community at the global level, including the BCBS and IOSCO as well as the Financial Stability Board (FSB). This monitoring has confirmed overall progress towards the implementation of the standards but has also highlighted certain areas where further consistency could be facilitated, or areas where the requirements could be clarified or slightly amended in order to facilitate their implementation.

In this context, and after the publication of the draft RTS on December 2019, the ESAs have published the **Final Report on EMIR RTS on various amendments to the bilateral margin requirements in view of the international framework** with the aim to introduce some amendments on the implementation regulation, such as the deferral of one year the implementation of the remaining phases of the initial margin requirements, as a consequence of the outbreak of COVID-19 or the clarification of the application of those requirements.

2. Main points

- **Proposed amendments and clarifications**:
    - Clarification of the requirements when below the €50 million initial margin threshold: the framework's implementation does not specify documentation, custodial or operational requirements if the bilateral initial margin amount does not exceed the framework's €50 million initial margin threshold.
    - Extension of the phase-in of the implementation of the initial margin requirements: the Basel Committee and IOSCO have agreed to extend by one year the final implementation of the margin requirements for covered entities with an aggregate average notional amount (AANA) of non-centrally cleared derivatives greater than €8 billion. Additionally, they introduce an additional implementation phase for covered entities with an AANA of non-centrally cleared derivatives greater than €50 billion
- **Implementation deferral**. The ESA have reviewed the application of the relevant requirements of EC's Regulation on bilateral margining and submitted the draft RTS in December 2019. However, in response to the Covid-19 outbreak in 2020, the Final Report has been updated to take into account the related decision from the BCBS and IOSCO communicated on 3 April 2020 to defer the implementation of the remaining phases of the initial margin requirements. Therefore, the final implementation phase will take place on 1 September 2022, at which point covered entities with an aggregate average notional amount (AANA) of non-centrally cleared derivatives greater than €8 billion will be subject to the requirements. As an intermediate step, from 1 September 2021 covered entities with an AANA of non-centrally cleared derivatives greater than €50 billion will be subject to the requirements.
- **Physically settled FX Forwards and Swaps**. BCBS and IOSCO agree the standards apply for variation margin to be exchanged on physically settled FX forwards and swaps in a manner consistent with the final policy framework set out in this guidance and that those variation margin standards are implemented either by way of supervisory guidance or national regulation. However, the adoption of the international standards in other jurisdictions via supervisory guidance had implied differences in international scope of application, especially on transactions between institutions and end-users. For this reason, the ESA have proposed to amend the regulation by broadening the scope on the treatment of physically settled foreign exchange forwards and physically settled foreign exchange swaps, applying the permanent exemption for certain contracts when entered into between institutions and end-users for both.

2. Main points (cont.)

- **Temporary exemption for single-stock equity options and index options**. The ESA postponed the application of bilateral margin requirements for single-stock equity options or index options transactions until 4 January 2020, in order to correct the differences in margin requirements between jurisdictions. However, the situation has not materially changed, thus the ESA propose to extend by one year the current deferred application of the margin requirements for single-stock equity options or index options transactions in the EU framework (i.e. 4 January 2021).
- **Temporary exemption for intragroup transactions**. The ESAs consider that it is proportionate to extend the temporary exemption for bilateral margin relates to intragroup transactions with a third country entity in the absence of an equivalence decision adopted by the European Commission. This proposal is aligned with the exemption for the clearing obligation (i.e. until 21 December 2020), being both to ensure that such intragroup OTC derivate contracts were not subject to the EMIR clearing or bilateral margin requirements before the adoption of the relevant equivalence decisions.

3. Next steps

- These amendments have been **submitted to the EC** for review and endorsement.

27/04/2020

- **Public Statement: Actions to mitigate the impact of COVID-19 on the EU financial markets regarding publication deadlines under the Transparency Directive**
- **Public Statement: Actions to mitigate the impact of COVID-19 on the deadlines for the publication of periodic reports by fund managers**
- **Extension of the response date for the Consultation Paper: MiFID II/ MiFIR review report on the transparency regime for non-equity instruments and the trading obligation for derivatives**
- **Public Statement: ESMA postpones the publication dates of the annual transparency calculations for non-equity instruments and for the quarterly systematic internaliser data for non-equity instruments other than bonds**
- **Public Statement: Actions to mitigate the impact of COVID-19 on the EU financial markets regarding the timeliness of fulfilling external audit requirements for interest rate benchmarks under the Benchmarks Regulation**

1. Context

Since the beginning of March, various agendcies at both the local and supranational levels have begun to issue measures to mitigate the possible impact that the COVID-19 could have on the economy. In Europe, the European Central Bank (ECB) has launched a new temporary asset purchase programme of private and public sector securities called the Pandemic Emergency Purchase Programme (PEPP) of €750 billion and it allow banks to temporarily operate below Pillar 2 Guidance (P2G), the CCB and the LCR requirement. Furthermore, the EBA has decided to postpone the EU-wide stress test exercise to 2021 and it will carry out an additional EU-wide transparency exercise in 2020, and the ESMA has issued a Guidance on accounting implications of COVID-19.

In this context, the ESMA has published a **Public Statement (PS) on actions to mitigate the impact of COVID-19 on the EU financial markets regarding publication deadlines under the Transparency Directive (TD)**. In particular, this PS recommends National Competent Authorities (NCAs) to apply forbearance powers towards issuers who need to delay publication of financial reports beyond the statutory deadline.

Furthermore, the ESMA has published 3 documents that postpone **the effective date for the presentation of responses to a consultation paper about MiFID II and MiFIR**, the **publication dates of the annual transparency calculations for non-equity instruments and for the quarterly systematic internaliser (SI) data for non-equity instruments other than bonds**, and the deadlines for the **publication of periodic reports by fund managers**. Finally, the ESMA has also issued a **Public Statement on Actions to mitigate the impact of COVID-19 on the EU financial markets regarding the timeliness of fulfilling external audit requirements for interest rate benchmarks under the Benchmarks Regulation**.

2. Main points

<u>Public Statement: Actions to mitigate the impact of COVID-19 on the EU financial markets regarding publication deadlines under the Transparency Directive</u>

- **Prorogation of deadlines**. The ESMA states that the preparation of periodic information must continue to be carried out in accordance with the applicable financial reporting framework to ensure investor protection and to preserve the integrity and proper functioning of EU financial markets. However, the ESMA encourages NCAs to act in a coordinated way and to generally apply a risk-based approach in the exercise of supervisory powers in their day-to-day enforcement of applicable legislation in the area of the TD concerning the publication deadline of financial reports. The ESMA expects NCAs during this specific period not to prioritise supervisory actions against issuers in respect of the upcoming deadlines set out in the TD regarding:
    - <u>Annual financial reports</u> referring to a year-end occurring on or after 31 December 2019 but before 1 April 2020 for a period of <u>two months following the TD deadline</u>.
    - <u>Half-yearly financial reports</u> referring to a reporting period ending on or after 31 December 2019 but before 1 April 2020 for a period of <u>one month following the TD deadline</u>.

  This PS will not be relevant to Member States where some measures regarding the applicable publication deadlines for financial reports have taken place or will take place.
- **Reporting of the delay**. Where issuers reasonably anticipate that publication of their financial reports will be delayed beyond the deadline set out in national laws transposing the TD, they are expected to inform their NCA of this and inform the market of the delay, the reasons for such delay and to the extent possible the estimated publication date.

2. Main points (cont.)

Public Statement: Actions to mitigate the impact of COVID-19 on the deadlines for the publication of periodic reports by fund managers

- **Publication deadlines for periodic information**. Considering that Fund Managers may be prevented from fulfilling the requirements due to COVID-19, ESMA expects NCAs to act in accordance with national rules set out in their Member States and when possible during this specific period not to prioritise supervisory actions against these market participants in respect of the upcoming deadlines regarding:
    - Annual reports referring to a year-end occurring on or after 31 December 2019 but before 1 April 2020 for a period of two months following the relevant deadline.
    - Annual reports referring to a year-end occurring on or after 1 April 2020 but before 1 May for a period of one month following the relevant deadline19.
    - Half-yearly reports of UCITS referring to a reporting period ending on or after 31 January 2020 but before 1 April 2020 for a period of one month following the deadline set out in the UCITS Directive.

Extension of the response date for the Consultation Paper: MiFID II/ MiFIR review report on the transparency regime for non-equity instruments and the trading obligation for derivatives

- **Extension of the response date**. The ESMA has extended the response date for the consultation on the MiFID II/MiFIR review report on the transparency regime for non-equity instruments and the trading obligation for derivatives from 17 May to 14 June 2020.

Public Statement: ESMA postpones the publication dates of the annual transparency calculations for non-equity instruments and for the quarterly systematic internaliser (SI) data for non-equity instruments other than bonds

- **New deadline for the publication of transparency and quarterly SI calculations**. The ESMA, in cooperation with the NCAs will postpone the publication of those calculations which include the liquidity assessment and the determination of the pre-trade and post-trade large in scale and size specific to the instrument thresholds from 30 April 2020 to 15 July 2020 and their application from 1 June 2020 to 15 September 2020. ESMA will publish the data for the performance of the SI test for derivatives, emission allowances and structured finance products by 1 August 2020 and its mandatory regime will apply from 15 September 2020.
- **Exceptions**. Until and including 14 September 2020 the transitional transparency calculations (TTC) will continue to apply. Furthermore, the publication and application of the annual transparency calculations for bonds remain unchanged and the new thresholds will be applicable from 1 June 2020.

Public Statement: Actions to mitigate the impact of COVID-19 on the EU financial markets regarding the timeliness of fulfilling external audit requirements for interest rate benchmarks under the Benchmarks Regulation

- **Timeliness of fulfilling the external audit requirements**. ESMA expects NCAs not to prioritise supervisory actions against administrators and supervised contributors relating to the timeliness of fulfilling those audit requirements where the audits are carried out by 30 September 2020.

3. Next steps

- The ESMA, together with NCAs, **will continue to closely monitor the situation** and will take or recommend any measures necessary to mitigate the impact of COVID-19 on timely and appropriate financial disclosure by issuers.

01/06/2020
Public Statement on Implications of the COVID-19 outbreak on the half-yearly financial reports

1. Context
The COVID-19 outbreak has posed significant challenges to business activities and introduced a high degree of uncertainty on the expected development of the pandemic and the associated knock-on effects on the economic and financial system, both at European and at international level. Given the complexities of the current environment the importance of providing the necessary level of transparency and quality in financial communication is greater than ever.

In this context, the ESMA has published a **Public Statement (PS) on Implications of the COVID-19 outbreak on the half-yearly financial reports** which promotes transparency and consistent application of European requirements for the information provided on the interim financial statements according to IFRS and the interim management reports for the 2020 half-yearly reporting periods. This PS provides recommendations and highlights: i) the importance of providing relevant and reliable information; ii) the importance of updating the information included in the latest annual accounts to adequately inform stakeholders of the impacts of COVID-19, and iii) the need for entity-specific information on the past and expected future impact of COVID-19 on the strategic orientation and targets, operations, performance of issuers as well as any mitigating actions put in place to address the effects of the pandemic.

2. Main points

- **Timing of publication of half-yearly financial reports 2020**. ESMA highlights that the key driver on issuing the half-yearly financial reports shall remain the objective of providing timely, relevant and reliable information, while not unduly delaying the publication of periodic information. In this respect, ESMA also reminds issuers to carefully consider the impact on their financial statements of any material events occurring after the end of the reporting period and to provide the relevant disclosures in accordance with IAS 34.
- **Half-yearly financial statements**. These financial statements have special aspects that must be taken in consideration in relation to:
    - Application of IAS 34. When preparing their interim financial statements in accordance with IAS 34, issuers are reminded and urged:
        - That the **extent of the information** provided should be proportionate to the objective of providing an update on the latest complete set of annual financial statements, including new events and circumstances as the COVID-19 outbreak.
        - To adjust and potentially expand the **level of detail** of the information provided in the half-yearly financial statements. It implies to comply with the disclosures requirements from individual IFRSs and IAS1 in relation to providing relevant information on the economic consequences arising from the COVID-19 outbreak.
        - To **provide transparency** regarding the application of the relief and support measures in terms of eligibility, conditions and consequences as well as in terms of the underlying judgements they made.
    - Disclosures reflecting significant uncertainties, going concern and risks linked to COVID-19. The COVID-19 outbreak has introduced uncertainty in the conduct of most businesses and, as a result, a significant risk of material adjustment to the carrying amounts of assets and liabilities may have arisen. In these cases, ESMA:
        - It urges issuers to **update the assessment made at year-end about the assumptions regarding the future** and other major sources of estimation uncertainty.
        - It expects issuers most significantly impacted by COVID-19, to **provide disclosures about the going concern assessment** and the related underlying judgements where these are significant.
        - It reminds issuers of the importance of providing disclosures regarding **risks which were in full or in part unknown** or not relevant at the end of the last annual reporting period and to consider the requirements in IFRS 7 regarding, especially on the exposures of issuers to credit, liquidity and other risks and the related sensitivities. Particularly, EBA notes the need of disclosure to explain the assumptions and judgments applied on the calculation of expected credit losses in accordance with IFRS 9.

2. Main points (cont.)

  - Impairment of non-financial assets. ESMA reminds issuers that, in accordance with IAS 36, they should assess whether there are any indications that an asset may be impaired on the basis of a set of internal and external sources of information. In making this assessment, issuers should carefully consider the effects of the COVID-19 outbreak which, in ESMA's view, would most likely constitute a strong basis to conclude that one or more of the impairment indicators in IAS 36 have been triggered. Particularly, ESMA notes that the determination of the recoverable amount in the current uncertain environment requires a careful assessment of the cash-flow projections over a relevant horizon considering multiple scenarios.
  - Presentation of COVID-19 related items in the statement of profit or loss. ESMA encourages issuers to provide information, on a quantitative basis, on the significant impacts of the COVID-19 outbreak as part of the explanations of the amounts presented and recognised in the statement of profit or loss in a single note as part of the notes to the financial statements.
  - Other disclosure requirements. ESMA highlights that issuers should consider whether other requirements in IFRS are also relevant in the context of their half yearly financial reporting (e.g. recognition of deferred tax assets or fair value measurement, among others).
- **Interim management reports**. ESMA recommends that issuers provide detailed and entity specific information in their interim management reports regarding:
  - The impact that the COVID-19 pandemic had on their strategic orientation and targets, operations, financial performance, financial position and cash-flows.
  - Measures taken to address and mitigate the impacts of the COVID-19 pandemic on their operations, performance and their state of completion (including, but not limited to, the detail of the application of public support measures and the planned renegotiation of major contracts)
  - The expected future impact on issuers' financial performance, financial position and cash-flows, related risks and contingency measures planned to mitigate the expected future impact and risk and uncertainties identified.
  - Narrative information regarding the estimates and judgements made as well as assumptions used to determine the future impact of the COVID-19 pandemic on the business of the issuer and how the different uncertainties faced affected the estimates made and the strategy undertaken by the issuer to address the impact of COVID-19.

3. Next steps

- ESMA will collect data on how EU listed entities have applied the recommendations and will take into account those findings, in setting the enforcement priorities for the annual financial statements for the year 2020. These findings will be reported on in **ESMA's Report on the 2020 enforcement activities**.

10/06/2020
Consultation Paper (CP) on Draft Guidelines (GL) on outsourcing to cloud service providers

1. Context

IT outsourcing is a common practice for firms, and cloud computing solutions are increasingly becoming the preferred IT outsourcing option for many firms. Although cloud outsourcing can offer a number of benefits, including reduced costs and enhanced operational efficiency and flexibility, it raises challenges in terms of data protection and information security. Concentration risk can also arise, as a result of many firms using the same large cloud service providers (CSP). In this sense, following the European Commission's FinTech Action Plan and feedback received from firms and stakeholders, ESMA identified the need to develop guidance on outsourcing to cloud service providers.

In this context, the ESMA has published a **Consultation Paper (CP) on Draft Guidelines (GL) on outsourcing to cloud service providers** with the aim to help firms to identify, address and monitor the risks that may arise from their cloud outsourcing arrangements (from making the decision to outsource, selecting a CSP, monitoring outsourced activities to providing for exit strategies).

2. Main points

- **Scope**. The Draft GL proposed applies to national competent authorities (NCAs) and financial market participants. In particular, this paper is of interest to alternative investment fund managers, depositaries of alternative investment funds, undertakings for collective investment in transferable securities (UCITS) management companies, depositaries of UCITS, central counterparties, trade repositories, investment firms and credit institutions which carry out investment services and activities, data reporting services providers, market operators of trading venues, central securities depositories, credit rating agencies, securitisation repositories and administrators of benchmarks ("firms").
- **Governance, oversight and documentation**. This CP establishes that with regard to governance, oversight and documentation firms should:
  - <u>Have a defined and up to date cloud outsourcing strategy</u> that is consistent with the firm's relevant strategies (e.g. ICT strategy or internal policies and processes).
  - <u>Monitor on an ongoing basis</u> the performance of activities, the security measures and the adherence to agreed service levels by its CSPs on a risk-based approach.
  - Maintain an <u>updated register of information on all its cloud outsourcing arrangements</u>, distinguishing between the outsourcing of <u>critical or important</u> functions and <u>other</u> outsourcing arrangements.
- **Pre-outsourcing analysis and due diligence**. In general, the pre-outsourcing analysis and due diligence should be proportionate to the nature, scale and complexity of the function that the firm intends to outsource and the risks inherent to this function. It should include at least an assessment of the potential impact of the cloud outsourcing arrangement on the firm's operational, legal, compliance, and reputational risks. Before entering into any cloud outsourcing arrangement, firms should: i) assess if the cloud outsourcing arrangement concerns a critical or important function; ii) identify and assess all relevant risks of the cloud outsourcing arrangement; iii) undertake appropriate due diligence on the prospective CSP; and iv) identify and assess any conflict of interest that the outsourcing may cause.
- **Contractual requirements**. This CP establishes that the respective rights and obligations of a firm and of its CSP should be clearly allocated and set out in a written agreement, which should expressly allow the possibility for the firm to terminate it where necessary.
- **Information security**. This CP sets out that firms should set information security requirements in its internal policies and procedures and within the cloud outsourcing written agreement and monitor compliance with these requirements on an ongoing basis, including to protect confidential, personal or otherwise sensitive data.
- **Exit strategies**. This CP establishes that in case of outsourcing of critical or important functions, firms should ensure that it is able to exit cloud outsourcing arrangements without undue disruption to its business activities and services to its clients, and without any detriment to its compliance with the applicable legal requirements, as well as the confidentiality, integrity and availability of its data. Furthermore, the firm should include indicators of the trigger events of the exit strategy in its ongoing monitoring and oversight of the services provided by the CSP.

2. Main points (cont.)

- **Access and audit rights**. This CP sets out that firms should ensure that the exercise of the access and audit rights (e.g. the audit frequency and the areas and services to be audited) takes into consideration whether the outsourcing is related to a critical or important function, as well as the nature and extent of the risks and impact arising from the cloud outsourcing arrangement on the firm. In case the exercise of the access or audit rights, or the use of certain audit techniques create a risk for the environment of the CSP and/or another CSP's client (e.g. by impacting service levels, confidentiality, integrity and availability of data), the firm and the CSP should agree on alternative ways to provide a similar result (e.g. the inclusion of specific controls to be tested in a specific report/certification produced by the CSP).
- **Sub-outsourcing**. This CP establishes that If sub-outsourcing of critical or important functions (or a part thereof) is permitted, the cloud outsourcing written agreement between the firm and the CSP should, among others, specify any part or aspect of the outsourced function that are excluded from potential sub-outsourcing, indicate the conditions to be complied with in case of sub-outsourcing; and include an obligation for the CSP to notify the firm of any planned sub-outsourcing, or material changes.
- **Written notification to competent authorities (CAs)**. This CP sets out that in case of planned outsourcing of critical or important functions, firms should notify its CA in a timely manner.
- **Supervision of cloud outsourcing arrangements**. CA should assess the risks arising from firms' cloud outsourcing arrangements as part of their supervisory process. In particular, this assessment should focus on the arrangements that relate to the outsourcing of critical or important functions. CAs should assess on a risk-based approach whether firms:
  - <u>Have in place the relevant governance, resources and operational processes</u> to appropriately and effectively enter into, implement, and oversee cloud outsourcing arrangements.
  - <u>Identify and manage all relevant risks</u> related to cloud outsourcing. If concentration risks are identified, CAs should monitor the development of such risks and evaluate both, their potential impact on other firms and the stability of the financial market.

3. Next steps

- Comments to this CP should be submitted by **1 September 2020**.
- It is expected that ESMA publishes a **final report and GL between Q4 2020 and Q1 2021**.
- The Final GL will apply from **30 June 2021** to all cloud outsourcing arrangements entered into, renewed or amended on or after this date. Firms should review and amend accordingly existing cloud outsourcing arrangements with a view to ensuring that they take into account these GL by **31 December 2022**, and if the revision is not finalized by then, firms should inform their CA.

10/06/2020
Guidelines on certain aspects of the MiFID II compliance function requirements

1. Context

In 2012, the ESMA published Guidelines on certain aspects of the MiFID compliance function requirements to clarify the application of certain aspects of the MiFID compliance function requirements in order to ensure the common, uniform and consistent application. However, since that publication, MiFID II was approved on 2014 by the European Parliament and Council, which brought some changes to the previous regulation.

In this context, the ESMA has published **Guidelines on certain aspects of the MiFID II compliance function requirements** with the aim to establish consistent, efficient and effective supervisory practices within the European System of Financial Supervision (ESFS) and to ensure the common, uniform and consistent application of certain aspects of the MiFID II compliance function. ESMA also expects these guidelines to promote greater convergence in the interpretation of, and supervisory approaches to, the aforementioned requirements by focusing on a number of important issues, and thereby enhancing the value of existing standards. These guidelines replace the ESMA guidelines on the same topic issued in 2012 and include updates that enhance clarity and foster greater convergence in the implementation, and supervision, of the new MiFID II compliance function requirements.

2. Main points

- **Scope**. These guidelines apply to competent authorities and to the following financial market participants:
  - Investment firms when carrying out investment services or investment activities or when selling or advising clients in relation to structured deposits.
  - Credit institutions when carrying out investment services or investment activities or when selling or advising clients in relation to structured deposits.
  - Undertakings for collective investment in transferable securities (UCITS) and alternative investment fund managers (AIFMs) management companies when providing investment services and activities in accordance with the UCITS Directive and the AIFMD.
- **Responsibilities of the compliance function**. It comprises the following guidelines:
  - Compliance risk assessment. The findings of the compliance risk assessment should be used to set the work programme of the compliance function and to allocate the functions resources efficiently. In identifying the level of compliance risk the firm faces, MiFID II requires the compliance function to take into account all the areas of the investment services, activities and ancillary services provided by the firm. The identified risks should be reviewed on a regular basis and, when necessary, also on an ad-hoc basis to ensure that any emerging risks are taken into consideration.
  - Monitoring obligations of the compliance function. The risk-based monitoring programme should evaluate whether the firm's business is conducted in compliance with its obligations under MiFID II as well as whether its internal policies and procedures, organisation and control measures remain effective and appropriate to ensure that compliance risk is comprehensively monitored. The risk-based approach to compliance should form the basis for determining the appropriate tools and methodologies used by the compliance function (e.g. risk indicators, exceptions report or the observation of procedures), as well as the extent of the monitoring programme and the frequency of monitoring activities performed by the compliance function.
  - Reporting obligations of the compliance function. The mandatory compliance reports should cover all business units involved in the provision of investment services, activities and ancillary services provided by a firm. Where the report does not cover all of these activities and services of the firm, it should clearly state the reasons. The mandatory compliance reports should, inter alia, contain information on the following matters, where relevant:
    - **General information** (e.g. adequacy and effectiveness of the firm's policies and procedures or a summary of the compliance function's structure).
    - **Manner of monitoring and reviewing** (e.g. how the compliance-function monitors the development and review of the obligations under MiFID II or the summary of on-site inspections or desk-based reviews).
    - **Findings** (e.g. a summary of major findings of the reviews or the breaches and deficiencies in the firm's organisation and compliance process).
    - **Actions taken** (e.g. any action taken to address any significant risk of failure by the firm or its staff to comply with the obligations under MiFID II).
    - **Others** (e.g. other significant compliance issues).

2. Main points (cont.)

  - Advisory and assistance obligations of the compliance function. Firms should ensure that the compliance function fulfils its advisory and assistance responsibilities, including providing support for staff and management training; providing day-to-day assistance for staff and management and participating in the establishment of policies and procedures within the firm. Firms should promote and enhance a 'compliance culture' throughout the firm, which should be supported by the senior management and its objective is to engage staff with the principle of improving investor protection as well as contributing to the stability of the financial system. Finally, firms should ensure that the compliance function is involved in the development of the relevant policies and procedures as well as all significant modifications of the organisation of the firm in the area of investment services, activities and ancillary services.

- **Organisational requirements of the compliance function**.
  - Effectiveness of the compliance function. Firms should take into account the scale and types of investment services, activities and ancillary services undertaken by the firm, in order to ensure that appropriate human and other resources are allocated to the compliance function. It implies that the firm should ensure that the compliance function is similarly extended as necessary in view of changes to the firm's compliance risk.
  - Skills, knowledge, expertise and authority of the compliance function. Firm's compliance staff shall have the necessary skills, knowledge and expertise to discharge their obligations pursuant to MIFID II. In particular, the compliance officer should demonstrate sufficient professional experience as it is necessary to be able to assess the compliance risks and conflicts of interest inherent in the firm's business activities.
  - Permanence of the compliance function. Firms should establish adequate arrangements for ensuring that the responsibilities of the compliance officer are fulfilled when the compliance officer is absent, and adequate arrangements to ensure that the responsibilities of the compliance function are performed on an ongoing basis.
  - Independence of the compliance function. Firms should ensure that the compliance function holds a position in their organisational structure that ensures that the compliance officer and other compliance staff act independently when performing their tasks. It also implies that other business units may not issue instructions or otherwise influence compliance staff and their activities and an appropriate escalation process by the compliance function to senior management should be implemented.
  - Proportionality with regard to the effectiveness of the compliance function. Firms should decide which measures are best suited to ensuring the effectiveness of the compliance function in the firm's particular circumstances. In particular, they should take into account the criteria set out in this guideline for deciding whether the requirements under MIFID II are proportionate (e.g. the type of business activity or staff headcount)
  - Combining the compliance function with other internal control functions. The combination of the compliance function with other control functions may be acceptable if this does not compromise the effectiveness and independence of the compliance function, except for the blend of internal audit and other control functions such as the compliance.
  - Outsourcing of the compliance function. According to MIFID II, firms can only outsource tasks, but not responsibilities. It means that the ability to control outsourced tasks and manage the risks associated with the outsourcing must always be retained by the firm initiating the outsourcing. Before choosing a service provider, the firm should perform a due diligence assessment and later, it should monitor the outsourced tasks, in order to ensure the service provider has the necessary authority, resources, expertise and access to all relevant information to perform the outsourced compliance function tasks effectively.

- **Competent authority review of the compliance function**.
  - Review of the compliance function by competent authorities. Competent authorities should review how firms plan to meet, implement and maintain the applicable compliance function requirements. This should apply in the context of the authorisation process, as well as, following a risk-based approach, in the course of on-going supervision.

3. Next steps

- These guidelines apply from **two months** of the date of publication of the guidelines on ESMA's website in all EU official languages. Competent authorities to which these guidelines apply must notify ESMA whether they
  - Comply.
  - Do not comply, but intend to comply.
  - Do not comply and do not intend to comply with the guidelines. In this case, the competent authorities must also notify ESMA within two months of the date of publication of the guidelines of their reasons for non-complying with them.

27/04/2020
Statement on principles to mitigate the impact of COVID-19 on the occupational pensions sector

1. Context

In 2016, the IORP II Directive sets minimum prudential rules for Institutions for Occupational Retirement Provision (IORPs) in the EU. However, regulation remained very diverse between Member States because occupational pension systems depend on the domestic legal system of each state. This diversity of the national regulatory frameworks is shown in differences in the extent to which risks are borne by members and beneficiaries, the IORP itself, sponsors and pension protection schemes.

In this context, the EIOPA has published the **Statement on principles to mitigate the impact of COVID-19 on the occupational pensions sector**. The objective is that National Competent Authorities (NCAs) of each member state adhere to these principles in order to mitigate the impact on IORPs and their members and beneficiaries, as well as to avoid pro-cyclical effects on the real economy and the financial system.

2. Main points

- **Business continuity and operational risks**.
    - NCAs should ensure that IORPs prioritise the continuity of key operational activities and allow them flexibility in the collection of contributions from employers facing liquidity pressures.
    - NCAs should expect IORPs to carefully consider and effectively manage the increased risk exposure to fraud, other criminal activity, cyber security and data protection due to the social impact of COVID-19 and, in particular, staff working remotely.
    - NCAs should be flexible with respect to deadlines for publication of documents and data considered less urgent and the national reporting requirements.
- **Liquidity positions**. NCAs should monitor the liquidity position of IORPs carefully and proportionately regarding liquidity pressures such as delayed or missing contributions from employers and employees and any moratorium on payments on loans and mortgages among others.
- **Funding situation and pro-cyclicality**. NCAs should closely monitor the impact of financial market developments on the financial position of IORPs providing defined benefit (DB) schemes and their compliance with national funding requirements. Additionally, they should seek to find an appropriate balance between safeguarding the long-term interests of beneficiaries and avoiding short-term pro-cyclical impacts on the real economy.
- **Protection of members and beneficiaries**. NCAs should encourage flexibility to safeguard members' pension rights and, particularly in defined contribution (DC) schemes, allow plan members to choose delayed application of lump sum payments or of mandatory annuitisation.
- **Communication**. NCAs should expect IORPs to communicate to their sponsors, members and beneficiaries on the impact of the coronavirus developments on the IORP's service continuity, economy and the future financial situation regarding retirement income of members and beneficiaries. In addition, they should discourage the making short-term decisions by members which could endanger long-term pensions outcomes.

3. Next steps

- EIOPA **has extended by two weeks** the deadline for the information regarding the **first quarter of 2020** and by **eight weeks** for the information regarding **annual reporting with reference to the year-end 2019**.

17/06/2020
Discussion paper on (re)insurance value chain and new business models arising from digitalisation

1. Context

As technology continues to evolve, increasing the extent and ways by which insurers rely on third-parties within the insurance value chain, and new opportunities, social change and consumers expectations arise, European Insurance and Occupational Pension Authority (EIOPA) has found increasing complexity in how insurance is being manufactured and distributed, with new kinds of distributors and products emerging that can challenge existing supervisory and regulatory practices. As a consequence, more attention to different companies involved throughout the value chain must be supervised or at least identified and overseen efficiently and effectively.

In this context, the EIOPA has published a **Discussion paper (DP) on (re)insurance value chain and new business models arising from digitalisation**, which main aim is to get a better picture on possible fragmentation of the EU insurance value chain and supervisory challenges in order to plan for next steps. In this sense, this DP acts as a first step scrutinising the situation with the purpose to support supervisors in these challenges. To achieve this, the EIOPA expects from interested parties their views on whether they agree with view of the risks and benefits, and whether they have any comments or additional proposals on proposed solutions and/or next steps.

2. Main points

- **Increased fragmentation of the value chain**. The use of third-party services and outsourcing, and the trends for the emergence of co-operation models where the insurance value chain (e.g. product design or pricing) is originated, raises a number of potential risk that other firms outside the insurance regulatory perimeter take a predominant position. The three primary drivers of fragmentation are:
    - <u>Technology firms</u> (outside the traditional insurance landscape), demonstrating that certain processes within the insurance value chain can be carried out cheaper, more efficiently and more effectively with new technologies.
    - <u>Customers increasingly purchasing and interacting with businesses via digital ecosystems / platforms</u> (increased digitalisation of consumer interactions).
    - <u>The offering of insurance policies is complemented with the provision of other ancillary services to consumers</u> (e.g. different risk-preventive/additional services such as geolocation in case of a car stolen or assistance in health insurance contracts).
- **Case studies**. The EIOPA staff and volunteering NCAs have conducted case studies on concrete business models as part of the exercise that can be seen as related to the fragmentation of the value chain, with the aim to start exploring potential issues (and benefits) in a much more concrete fashion:
    - <u>Insurance platforms and ecosystems</u>. There has been general rapid growth of digital platforms and ecosystems in recent times, being the platform the technical infrastructure necessary for multiple participants to connect, interact with each other and create and exchange value, and the ecosystem, an interconnected set of services that allows participants to address a broad variety of client needs in one integrated experience.
    - <u>On-demand insurance</u>. It is an insurance cover tied to the actual time spent 'on risk' (e.g. kilometres driven) rather than the policy being 'live' for an extended period of time (e.g. 1 year).
    - <u>Instant insurance</u>. The emerging business model is so called 'instant' or 'push' insurance, which could be seen as a subcategory of on-demand insurance and where a technology provider sets up a platform to combine Big Data Analytics (BDA) with the management of contacts with customers.
    - <u>Preventive services in insurance</u>. Digital technologies and increasing access to data provide insurance companies with the possibility to offer different preventive services as an addition to traditional insurance cover. Such efforts could not just be beneficial for the single policyholder but also the whole economy by reducing claims and / or their costs.

2. Main points (cont.)

- **Risk and benefits for consumers and for the industry**. EIOPA has looked at potential innovation-related risks and benefits through its different work streams for customers (e.g. benefits: increased competition, and risks: lack of transparency) and for the industry (e.g. benefits: faster product development cycles, and risks: uncertainty related to new and untried technology / business models). Most of the risks identified are not new, however, the increased use of third parties, fragmentation of the value chain and digitalization in general can be seen as an amplifier of these risks.
- **Supervisory implications**. More complex value chains entail more complex supervision, focused, for instance, on the crystallisation of new risks through interactions of parties. Supervisors might need to develop knowledge, experience, data access, skillset and resources for supervising new models and technologies, causing challenges to keep up with the rapid changes.
    - <u>Risk related to fragmentation and increased complexity</u>. In order to make supervision more effective, supervisors need to understand the individual and collective impact of new technology-led business models/strategies.
    - <u>Concentration risk</u> could also increase due to the extended use of third parties, especially in the context of insurance platforms and ecosystems.
    - <u>Specific concerns related to insurance platforms/ecosystems</u>, platforms and ecosystems will shift value and change the nature of risk, keeping in mind that those players have the capability to scale at a far faster rate than companies could in the past.

3. Next steps

- The deadline for submission of feedback on the public consultation shall be **September 7th 2020**.

03/04/2020
Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis

1. Context

The outbreak of the COVID-19 pandemic and the response measures that have been adopted in many countries across the globe and in the EU, have significant economic consequences. In these circumstances, in order to minimize the medium- and long –term economic impacts, Member States have implemented a broad range of support measures including, among others, some forms of moratorium on payments of credit obligations. In this sense, the EBA has clarified a number of aspects in relation to the use of public and private payment moratoria.

In this context, the EBA has issued **Guidelines (GL) on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis** in order to provide clarity on the treatment of the moratoria applied before 30 June 2020. In particular, these GL clarify which legislative and non-legislative moratoria do not to trigger forbearance classification, while in all other cases the assessment must be done on a case-by case basis.

2. Main points

- **Criteria for general payment moratoria**. A moratorium should be considered a general payment moratorium where all the following conditions are met:
  - The moratorium is based on the applicable national law (legislative moratorium) or on a non-legislative payment relief initiative of an institution as part of an industry moratorium scheme agreed or coordinated within the banking industry or a material part thereof, possibly in collaboration with public authorities, such that participation in the moratorium scheme is open and similar payment relief measures are taken under this scheme by relevant credit institutions (non-legislative moratorium).
  - The moratorium applies to a large group of obligors predefined on the basis of broad criteria (e.g. the exposure class, industry sector, product ranges or geographical location). The scope of application of the moratorium may be limited only to performing obligors, who did not experience any payment difficulties before the application of the moratorium, but it should not be limited only to those obligors who experienced financial difficulties before the outbreak of COVID-19 pandemic.
  - The moratorium envisages only changes to the schedules of payments for a predefined limited period of time.
  - The moratorium offers the same conditions for the changes of the payments schedules to all exposures subject to the moratorium.
  - The moratorium does not apply to new loan contracts granted after the date when the moratorium was announced.
  - The moratorium was launched in response to the COVID-19 pandemic and was applied before 30 June 2020. This deadline can be revised in the future depending on the evolution of the current situation.
- **Classification under the definition of forbearance**. The application of the general payment moratorium in itself should not lead to reclassification of the exposure as forborne (either performing or non-performing) unless an exposure has already been classified as forborne at the moment of the application of the moratorium.
- **Application of the definition of default to exposures subject to payment moratoria**. Where a general payment moratorium meets the conditions, institutions should count the days past due based on the revised schedule of payments, resulting from the application of any moratorium. In addition throughout the duration of the moratorium, institutions should assess the potential unlikeliness to pay of obligors following the end of the application of the moratoria, prioritizing the assessment of the following cases: i) where obligors experienced payment delays shortly after the end of the moratorium; ii) where any forbearance measures are applied shortly after the end of the moratorium.
- **Documentation and notifications**. Institutions applying non-legislative general payment moratorium, should notify their national competent authority (NCA). The NCAs should notify the EBA of any use of general payment moratoria in their jurisdictions and provide certain information (e.g. if it is a legislative or non-legislative moratorium or the date from which the moratorium applies).

3. Next steps

- Competent authorities must notify the EBA whether they comply or intend to comply with these guidelines, or otherwise give their reasons for non-compliance, by **3 June 2020**.

14/04/2020

- **Final draft RTS on Liquidity Horizon for the IMA**
- **Final draft RTS on Backtesting and PLA requirements**
- **Final draft RTS on Risk factor modellability**

1. Context

In January 2019, the BCBS finalised and published standards on Minimum capital requirement for market risk (revised FRTB), which replaces the previous minimum capital requirements for market risk in the global regulatory framework, implemented in the EU via the CRR. Further, in June 2019 the European Parliament (EP) and the Council issued CRR II introduces reporting requirements under FRTB IMA (June 2023) and FRTB SA (March 2021). The European Commission (EC) is expected to present a legislative proposal in June 2020 detailing how this regulation will be implemented. However, key parts of the framework relating to the FRTB revisions will be implemented through a Commission Delegated Act and EBA technical standards.

In this context, and after the publication of the consultation papers in June 2019, the EBA has published three **Final drafts on RTS on the new internal model approach (IMA) under the FRTB** in order to specify essential aspects of the IMA and contribute to a smooth and harmonised implementation of the FRTB in the EU. In particular, these documents are the Final draft on RTS on liquidity horizons, the Final draft on RTS on back-testing and profit and loss attribution (PLA) requirements and, the Final draft on RTS on criteria for assessing the modellability of risk factors under the IMA.

2. Main points

<u>Final draft RTS on liquidity horizons for the IMA</u>

- **Scope**. According to the CRR II, institutions are required to map each risk factor to one of the risk factor categories and to one of the risk factor subcategories listed (e.g. most liquid currencies and domestic currency, or volatility for interest rate risk factor's category) for the purpose of identifying the relevant liquidity horizon under the IMA.
- **Content**. This document specifies the following aspects:
    - <u>Mapping of risk factors to risk factor categories and subcategories</u>, by providing ad hoc treatments for some specific risk factors as well as a general approach for the majority of cases.
    - <u>Definition of most liquid currencies for interest rate risk</u>, by establishing that those currencies are defined considering the Triennial Central Bank Survey Over the Counter (OTC) interest rate derivatives turnover compiled by the Bank of International Settlements (BIS).
    - <u>Most liquid currency pairs for FX risk</u>, by defining them also considering the Triennial Central Bank Survey foreign exchange turnover compiled by BIS.
    - <u>Definition of a small and large capitalisation for equities</u>:
        - It is considered a **large capitalization** a market capitalisation equal to or greater than EUR 1.75 billion and equities in indices listed in the ESMA ITS which its components are all quoted in the EU.
        - It is considered a **small capitalization** all capitalisation that does not fall within the scope of large capitalisation.

<u>Final draft RTS on back-testing and profit and loss attribution (PLA) requirements</u>

- **Scope**. According to the CRR II, credit institutions should use an IMA that is reliable in determining capital requirements relative to the Profit & Loss (P&L) of the institution. To this end, two ways of assessing that a model is reliable are the regulatory backtesting programme and the PLA test.
- **Content**. This document specifies the following aspects:
    - <u>Definition of actual and hypothetical P&L</u>, for the purpose of both backtesting performed at trading desk level and backtesting performed on the portfolio of all positions attributed to these trading desks.
    - <u>The PLA test</u>, by providing:
        - The **criteria** ensuring that theoretical changes in a trading desk portfolio's value are sufficiently close to the hypothetical changes.
        - The **consequences** for an institution with one (or multiple) trading desk(s) with theoretical and hypothetical changes in the portfolio(s) value(s) not sufficiently close.
        - The **frequency** at which the P&L attribution test should be performed.
        - The **definition** hypothetical P&L and risk-theoretical P&L (RTPL).
        - The way institutions using the **internal model** for some desks have to aggregate the total own funds requirement for market risk of all their trading book positions and non-trading book positions bearing FX or commodity risk.

2. Main points (cont.)

Final draft RTS on criteria for assessing the modellability of risk factors under the IMA

- **Scope**. According to the CRR II, institutions shall assess the modellability of all the risk factors of the positions assigned to the trading desks for which they have been granted permission or are in the process of being granted such permission.
- **Content**. This document specifies the following aspects:
  - The methodology of the modellability assessment of a risk factor by:
    - Identification at a minimum of **24 verifiable prices** which are representative for the risk factor over the preceding 12-months, without any period of 90 days or longer with less than four verifiable prices which are representative for the risk factor.
    - Identification at a minimum of **100 verifiable prices** which are representative for the risk factor over the preceding 12-months.
  - The requirements a price should satisfy to be verifiable and the representativeness of verifiable prices for risk factors.

3. Next steps

- The adoption of these RTS is expected, under CRR II, to trigger the **three-year period** after which institutions with the permission to use the FRTB internal models are required to calculate their own funds requirements for market risk with those internal models.

04/05/2020

- **Final RTS on prudent valuation under CRR**
- **EBA statement on additional supervisory measures in the COVID-19 pandemic**
- **EBA Statement on the application of the prudential framework on targeted aspects in the area of market risk in the COVID-19**

1. Context

Since the beginning of March, various agencies at both the local and supranational levels have issued measures to mitigate the possible impact that the COVID-19 could have on the economy. In Europe, the European Central Bank (ECB) has launched a new temporary asset purchase programme of private and public sector securities called the Pandemic Emergency Purchase Programme (PEPP) of €750 billion and it allow banks to temporarily operate below P2G, the CCB and the LCR requirement. Furthermore, the EBA has decided to postpone the EU-wide stress test exercise to 2021 and it will carry out an additional EU-wide transparency exercise in 2020. In addition, the ECB has introduced supervisory flexibility regarding the treatment of non-performing loans (NPLs), recommended banks to avoid procyclical assumptions in their models to determine provisions on IFRS 9 and postpone some inspections.

In this context, the EBA has issued **Guidance on the use of flexibility in relation to COVID-19 and attention to risks** in order to provide further clarity on how additional flexibility will guide supervisory approaches in relation to market risk, the Supervisory Review and Evaluation Process (SREP), recovery planning, digital operational resilience and ICT risk and securitisation.

2. Main points

Final RTS on prudent valuation under CRR

- **Higher value aggregation factor**. Increase of the aggregation factor applicable to the core approach from 50% to 66% for the present period of extreme volatility in market prices and unprecedented systemic impact. While using the 66% aggregation factor, institutions are required to continue computing additional valuation adjustments (AVAs) in accordance with the requirements and with the principles prevailing before the crisis.

EBA statement on additional supervisory measures in the COVID-19 pandemic

- **SREP**. Due to the need of a pragmatic and effective SREP, the 2020 exercise will entail a risk-driven supervisory assessment focusing on the most material risks and vulnerabilities driven by the crisis based on most recent information received by supervisors. In addition, for some SREP elements, considered not directly affected by the crisis or where no new relevant information is available, the previously assigned supervisory assessment could be maintained. The EBA emphasises that drawing supervisory conclusions on the viability of institutions and their ability to meet the capital and liquidity requirements is paramount.
- **Recovery planning**. Competent authorities (CAs) should monitor that recovery plans are updated regularly and on an ad-hoc basis in order to be implemented timely and effectively if needed, in particular following changes with potential material impact on the plans or where material deficiencies have been identified. Some elements of recovery plans could be under operational relief in the 2020 recovery planning cycle (e.g. business-as-usual governances, description of the institution/entities covered by a group recovery plan, description of critical functions and core business lines, as well as their mapping, or communication plan).
- **Digital operational resilience**. The EBA calls on financial institutions:
    - To ensure an adequate internal governance, internal control framework, appropriate ICT capacity and security risk management, effective crisis communication measures and business continuity plans are up to date and adapted.
    - To stay vigilant in their cyber security monitoring and measures.
    - To monitor and seek assurance on the level of compliance of their third party providers.
- **Securitisation**. EBA clarifies certain ambiguities arising from the application of general payment moratoria. In particular, this statement provides clarifications on the application of the Guidelines on COVID-19 in relation to: i) securitised exposures, with regard to traditional securitisations and synthetic securitisations, and securitisation positions; and ii) the implicit support in the event of a payment moratorium.

2. Main points (cont.)

EBA Statement on the application of the prudential framework on targeted aspects in the area of market risk in the COVID-19

- **FRTB-SA reporting requirements**. EBA proposes to postpone the FRTB-SA reporting requirement under the CRR II until September 2021 in order to alleviate any potential operational burden.
- **Implementation of phase V and VI of the implementation of the Joint ESAs RTS on non-cleared OTC derivatives**. EBA proposes to postpone one year the final two implementation phases of the margin requirements for non-centrally cleared derivatives in order to free up operational capacity for banks to respond to the COVID-19 crisis.
- **Limitation of multiplication factors under internal models approach (IMA) for market risk**. EBA proposes that CAs may reduce in individual cases the first addend of the VaR multiplier to the minimum of 3, and limit the second addend to that resulting from overshootings under hypothetical changes, under certain conditions.

3. Next steps

- The Final RTS on prudent valuation under CRR will enter into force **on the day following that of its publication** in the Official Journal of the European Union (OJEU).
- The aggregation factor shall be set to 66% from the date of entry into force of this Regulation until **31 December 2020** with a transitional nature.

11/05/2020

Final report on the Draft implementing technical standards (ITS) on specific reporting requirements for market risk

1. Context

CRR2 introduces the first elements of the Fundamental Review of the Trading Book (FRTB), initiated by the Basel Committee on Banking Supervision (BCBS), into the prudential framework of the EU. Despite not yet being binding in terms of own funds requirements, the framework is implemented by means of a reporting requirement, constituting the first step towards the full implementation of the FRTB framework in the EU.

In this context, and after the publication of the Consultation Paper (CP) on November 2019, the EBA has published the **Final report on the Draft (ITS) on specific reporting requirements for market risk** which includes a thresholds template, providing insights into the size of institutions' trading books and the volume of their business subject to market risk, and a summary template, reflecting the own funds requirements under the alternative standardised approach for market risk (MKR-ASA).

Furthermore, along with the publication of the Final ITS, the EBA has also published the Annexes with the reporting templates.

2. Main points

- **Reference dates and remittance dates for reporting**.
  - Institutions shall submit information to competent authorities (CAs) with a quarterly frequency as this information stands on the 31 March, 30 June, 30 September and 31 December.
  - Institutions shall submit information to CAs by close of business of the following remittance dates: 12 May, 11 August, 11 November and 11 February.
- **Reporting on thresholds**. These Final ITS establishes that Institutions have to report information on the size of their trading book and the size of their on- and off-balance sheet business subject to market risk on an individual basis or consolidated basis, due to what CRR states.
- **Reporting on the Alternative Standardised Approach (ASA)**. These Final ITS introduces that institutions shall submit on an individual or consolidated basis the information regarding own funds in accordance to the specific reporting requirements for market risk ASA.
- **Data precision and information associated with submissions**. These Final ITS establishes that institutions have to submit the information in the data exchange formats and representations specified by CAs and respecting the data point definition of the data point model, among other specifications.

3. Next steps

- These ITS shall enter into force **20 days after its publication** in the Official Journal of the European Union (OJEU).
- These ITS will apply from **1 September 2021**.
- The EBA will also **develop the data-point model (DPM), XBRL taxonomy and validation rules** based on the final draft ITS and publish them soon.

25/05/2020

Guidelines on the determination of the weighted average maturity (WAM) of the contractual payments due under the tranche in accordance with point (a) of Article 257(1) of Regulation (EU) No 575/2013

1. Context

Regulation on Capital Requirements Regulation (CRR) as amended by Regulation (EU) 2017/2401 has introduced tranche maturity as an additional parameter in the CRR formulae to calculate the risk weights of securitisation positions. Institutions using the internal ratings-based approach (SEC-IRBA) or the SEC-ERBA are now required to include this parameter when calculating the risk-weighted exposure amounts applicable to their securitisation positions. According to CRR, two alternative approaches may be applied when determining the maturity of a tranche: (i) the weighted average maturity (WAM) of the contractual payments due under the tranche or (ii) the final legal maturity of the tranche. In both cases, the tranche maturity is subject to a floor of 1 year and a cap of 5 years. The choice between the WAM approach and the final legal maturity approach is left to the discretion of the institutions.

In this context, the EBA has issued **Guidelines on the determination of the WAM of the contractual payments due under the tranche in accordance with point (a) of Article 257(1) of CRR** with the aim to provide guiding principles for the institutions that opt for the use of the WAM approach instead of the final legal maturity approach when calculating the risk-weighted exposure amounts for the specific purpose of determining the capital requirement of a securitisation position.

2. Main points

- **Contractual payments**. Given the different source of cash flows generated within traditional and synthetic securitisations, the guidelines provide two different methodologies for the purpose of calculating the WAM of a tranche:
    - In the case of <u>traditional securitisation</u>, the contractual payments due under the tranche should be understood as the combination of: (i) the contractual payments of the underlying exposures payable to the securitisation special purpose entity (SSPE) and (ii) the contractual payments payable by the SSPE to the tranche holders.
    - In the case of <u>synthetic securitisations</u>, the contractual payments due under the tranche should be understood as the sum of: (i) the contractual payments of the premia payable by the originator to the protection provider and (ii) the contractual payments received by the originator from the borrowers of the underlying exposures that are allocated to the reduction of the outstanding amount of the tranche.
- **Data and information**. The institution could use the WAM approach under the following requirements regarding data and information:
    - <u>Use of internal and external data</u>: institutions should use internal data on the underlying portfolio of the securitised exposures, where they are the servicer of the securitised exposures. On the contrary, institutions are not the servicer of the securitised exposures and does not have access to internal data, they should only use the sources of external data set out in the GL (e.g. data provided by the originator, SSPE, etc.)
    - <u>Data on the underlying pool of exposures</u>: for using this approach, the data necessary to apply the asset model should be complete. Where the data necessary to apply the asset model are incomplete, institutions should make the necessary adjustments as set out in the GL, except that they do not have the data related to current principal balance or the currency denomination of the underlying exposures because, in such a case, they should not use the WAM approach.
    - <u>Reliable information for the calculation of contractual payments</u>: the transaction documentation should be the main source of information, especially for investor institutions have only the former information and the data provided by servicer institution. However, the servicer has all information related to underlying exposures for the calculation of contractual payments.

2. Main points (cont.)

- **Asset model**:
  - General provisions: institutions should determine all contractual payments payable to the SSPE generated by the portfolio during period t with the asset model. Institutions should use as key parameters all relevant information that may affect those payments, including the principal, interest and fees, and determine payments on a loan-by-loan basis.
  - Methodology for performing underlying exposures: this GL set up the requirements for the calculation of payments of principal and interest taking into account terms and conditions agreed and the amortization method. Additionally, other statements are the treatment of revolving periods, the application of prepayment regarding the historical information or the assumption of future default exposures equal to zero at the time of the WAM calculation.
  - Methodology for non-performing exposures: the principal and interest payments of exposures not performing at the time of the calculation of the WAM should be assumed to be equal to zero throughout the life of the securitisation. In addition, this GL also set up recovery rate and recovery-timing assumptions.
- **Liability model**:
  - General provisions: all the input variables used in the liability model should accurately take into account the contractual terms and conditions of the transaction set out in the securitisation transaction documentation. Further, it should be taken into account all relevant information on the tranches (e.g. final legal maturity, the payment frequency, the interests, etc.), the key structural features such as the priority of payments and related triggers, and hedging arrangements, structural protection mechanisms, costs and fees.
  - Determination of the total amount payable by the SSPE and allocation of the contractual payments among the tranche holders: the total amount payable is calculated by asset model and adjusted to account for any cash flows coming from the hedging arrangements and structural protection mechanisms and the fees and costs to be incurred by the SSPE. According to allocation of the contractual payments among the tranche holders, it has to be done considering contractual terms specially on priority of payment, amortization profile and other triggers based on the performance of the underlying assets.
- **Methodology for determining the contractual payments due under the tranche in case of synthetic securitisations**. The GL pointed out that institutions should determine the contractual payments payable to the originator by the borrowers of the underlying exposures by applying the same methodology as for the performing exposures in traditional securitisations. In addition, institutions should allocate the previous contractual payments to the tranches by reducing their outstanding amounts, in accordance with the allocation set out in the terms and conditions of the transaction. The GL also set up other statements in relation with the amortization method or taking into account optional features such as clean-up call or early redemption of the notes before the securitised exposures are fully amortised.
- **Monitoring and implementation of the WAM approach**. The models used for the application of the WAM approach should be monitored and updated whenever necessary to account for any variations of the key parameters (e.g. the outstanding note balance or the performance of the transaction) and any other material changes to the transaction such as the restructuring of notes or of the underlying exposures. Finally, the annual review of models by independent auditor (internal and external) should at least assess the quality of the process, the accuracy of the process to gather the key parameters with regard to the terms and conditions of the transaction documentation and the correctness of the overall calculation.

3. Next steps

- These guidelines apply from **1 September 2020**.

25/05/2020

Final Report on the Guidelines on credit risk mitigation (CRM) for institutions applying the IRB approach with own estimates of Loss Given Defaults (LGDs)

1. Context

In March 2018 the EBA published a Report on the CRM framework which carried out a mapping of relevant provisions to the corresponding credit risk approach, detailing the provisions for the techniques, eligibility and methods of CRM available to institutions under the Standardised Approach (SA) and the Foundation-IRB Approach (F-IRB).

In this context, the EBA has published a **Final Report on the Guidelines (GL) on CRM for institutions applying the IRB approach with own estimates of Loss Given Defaults (LGDs)**. In particular, these GL provide additional clarity on the application of the CRM approach for advanced internal rating based approach (A-IRB) institutions, focusing on clarifying the application of the current CRR provisions for the eligibility and methods of different CRM techniques, i.e. funded credit protection (FCP) and unfunded credit protection (UFCP). This is supplemented by additional detailed guidance on eligibility requirements and treatment of FCP or UFCP.

2. Main points

- **General provisions**. For exposures to which an institution applies the SA and the F-IRB approach the CRM techniques may be recognised in accordance with the chapter related to CRM of the CRR (Part Three, Title II, Chapter 4), whereas for exposures to which an institution applies the A-IRB approach the CRM techniques may be recognised in its chapter (Part Three, Title II, Chapter 3). In this sense, these GL clarifies that the requirements stablished in the CRM chapter will only apply to exposures treated under A-IRB where it is explicitly cross-referenced. In particular:
    - The CRM effects of <u>master netting agreements (MNA) and on-balance sheet netting (OBSN)</u> may be recognised only through adjustment of the exposure value subject to all the requirements established in the CRM chapter (including eligibility requirements and methods).
    - For the purpose of estimating LGD, the <u>references to 'collateral' should be understood as references to FCP other than MNA and OBSN</u>. In this sense, as MNA and OBSN are already recognised in the adjustment of the exposure value, their effect should not be recognised again through LGD.
    - The <u>method for the recognition of UFCP by institutions using the A-IRB approach has been specified in the CRR for both retail and non-retail exposures</u>. UFCPs may be recognised by adjusting PD or LGD estimates according to the CRR and under the constraint that the resulting adjusted risk weight should not be lower than the institution would assign to a comparable direct exposure to the guarantor (the risk weight floor). Alternatively, where institutions meet the <u>CRM chapter requirements for UFCP</u>, they may recognize the effects of the UFCP, the 'double default' formula applicable to exposures under both the F-IRB and A-IRB approaches.
    - <u>Credit insurance</u> may be recognised as a guarantee (or a credit derivative) where it effectively functions in an equivalent manner.
    - The treatment of <u>rating of third parties</u> is not considered a method for recognizing CRM, since it relates to a type of contractual support provided by a third party to the obligor.
- **Eligibility requirements**.
    - <u>Eligibility requirements for FCP</u>. With regard to FCP the CRR establishes that, if collateral is taken into account in the LGD estimation, institutions should set internal requirements for collateral management, legal certainty and risk management that are generally consistent with the covered in the CRM chapter in the CRR, but there is a lack of guidance on the concept of general consistency. In this regard, these GL provide the following two clarifications:
        - The **general eligibility principles on legal certainty and collateral valuation** form a minimum set of eligibility requirements that is meant to ensure that all collateral types are subject to the assessment of legal certainty (e.g. institutions should establish internal requirements which ensure that the collateral agreement is legally effective and enforceable) and collateral valuation applicable to all types of collateral used in the LGD estimation (e.g. institutions should specify in their internal policies the rules governing the revaluation of the collateral).
        - A **mapping to legal certainty and collateral valuation** is addressed in this GL by providing specific minimum criteria that entities must consider for a broad categories of collateral (financial, real estate, payment, physical collateral and other collateral).
    - <u>Eligibility requirements for UFCP</u>. The CRR establishes legal certainty requirements for the assessment of guarantees and credit derivatives with the aim to ensure that the guarantees are binding on all parties and that the creditor has the power to realise the guarantee.

2. Main points (cont.)

- **The Effects of CRM**. These GL provide guidance on how institutions may recognise the CRM effects of UFCP and FCP such as MNA and OBSN, even so they do not do not prescribe any specific methodology to be used. However, it is considered appropriate to specify certain principles that should be adhered to regardless of the methodology that is chosen.
    - The effects of FCP. These GL clarify that for the purposes of recognising the CRM effects of MNA and OBSN, institutions should use the fully adjusted exposure value (E*). Furthermore, for the purposes of LGD estimation institutions should calculate the realised LGD for each exposure that is covered by a MNA or OBSN as the ratio of the economic loss to the outstanding amount of the credit obligation at the moment of default calculated as E*. Institutions should calculate the economic loss on the basis of this outstanding amount, and no cash flows from netting should be included as recoveries after default in the economic loss. For the purposes of recognising the credit risk mitigation effects of collateral, the criteria specified by institutions for adjusting LGD estimates should:
        - **Not lead to a decrease in the value of the LGD estimates when the collateral** is a liability of the obligor that ranks either lower than or in the same conditions with the obligation the obligor has to the institution.
        - For other than first rank claims, **appropriately consider the effects on LGD estimates** of the subordinated position of the institution in relation to the collateral.
        - For other physical collateral, **appropriately consider the likely location of the collateral** during the lifetime of the loan and the influence it may have on the potential inability of institutions to expeditiously gain control of their collateral and liquidate it.
    - The effects of UFCP. Institutions may recognise the CRM effects of UFCPs using one of the following methods:
        - Adjustment of **PD or LGD estimates** on the basis of the criteria specified by institutions. In this sense, the CRR specifies how institutions may adjust their risk parameters in order to recognize the effects of guarantees and credit derivatives.
        - If the institution applies the SA for **comparable direct exposures to the guarantor**, and does not recognise the credit risk mitigation effects of the UFCP in the PD and LGD estimates, it may use the risk weight applicable under the SA, i.e. the substitution of risk weight approach.
        - Calculation of the **risk-weighted exposure amount**, i.e. the double default treatment.

3. Next steps

- These GL will apply from **1 January 2022**. Institutions should incorporate the requirements of these guidelines in their rating systems by that time, but competent authorities may accelerate the timeline of this transition at their discretion.

25/05/2020

Report on STS Framework for Synthetic Securitisation

1. Context

In December 2015 the EBA issued the Report on Synthetic Securitisation which contained an analysis and market practice assessment of the synthetic securitisation market. In this report, the EBA proposed extending the simple, transparent and standardised (STS) synthetic securitisation framework to fully cash-funded credit protection provided by private investors and amending the criteria determining the eligibility for STS preferential treatment for balance-sheet synthetic securitization. Subsequently, in September 2017, the EBA published the EBA Discussion Paper on Significant Risk Transfer (SRT) in Securitisation, which set out detailed proposals to strengthen the regulation and supervision framework of SRT associated with the traditional and synthetic securitisation, as well as it proposed a number of recommendations for the harmonisation of structural features widely present in synthetic and/or traditional securitisation. Finally, the EBA issued a discussion paper on the STS framework for synthetic securitization in September 2019 for a 2-month consultation period and as a result, there was a clear request from all stakeholders for the introduction of a preferential capital treatment of the STS synthetic securitisation, in the belief that the impact of STS synthetic securitisations would be limited if no differentiated capital treatment were introduced.

In this context, as a response to the mandate assigned to the EBA in the Securitisation Regulation, the EBA has issued a **Report on STS Framework for Synthetic Securitisation** with the aim of setting out an extensive analysis of the synthetic securitisation market developments and trends in the EU, including data on the historical default and loss performance of the synthetic transactions, both before and after the financial crisis (up until the end of 2018). In addition, this document examines the rationale of the STS synthetic product and assesses the positive and negative implications of its possible introduction.

2. Main points

- **Market developments and trends**. The development of the synthetic securitisation market in the EU can be divided into two episodes, before and after the financial crisis, with a number of significant differences between these two periods. A summary of the main changes is provided below.
  - While the majority of the transactions in the pre-crisis period were arbitrage transactions, after the crisis the European market was formed almost exclusively by balance-sheet transactions.
  - In contrast to the pre-crisis period when a substantial proportion of synthetic securitisation transactions were public and rated, since the financial crisis the deals have mostly been executed privately/bilaterally, without any involvement of the credit rating agencies.
  - With regard to originators' involvement, whereas, before the crisis, originators used to place super senior tranches (typically the largest tranches of a transaction in terms of volume), after the transition from Basel I and Basel II, they started placing only mezzanine or mezzanine/first loss (smaller) tranches.
  - With regard to the credit protection mechanism used, unfunded credit protection was the prevalent credit protection mechanism applied before the financial crisis, whereas funded protection became the dominant mechanism after the crisis.
- **Rationale for the development of the STS framework for synthetic securitisation**. The last trends suggest that there is sound appetite and potential for the growth of the synthetic market on the originator side and it shows that it has been overcome the stigma that has been associated with synthetic securitisation during the post-crisis period. Consequently, it arises the need of setting up a STS framework for synthetic securitisation, which should be adapted to the specificities of this type of securitisation. In particular, the counterparty credit risk potentially arising in the credit protection contract is the only element of complexity that is specific to synthetic securitisation. Counterparty credit risk may arise for:
  - The originator of the transaction (the protection buyer) because of the risk of default (or other events) in relation to the investor (the protection seller), resulting in a lack of credit protection.
  - The investor (protection seller) because of the risk of default (or other events) in relation to the originator, resulting in missed premium/fee payments by the originator and, if applicable, the loss of collateral posted by the investor to the originator or to a third party to fund the credit protection.

  Finally, the EBA assesses the pros and cons of the development of an STS synthetic product and mainly points out the following implications:
  - Pros: (i) increased transparency of the product; (ii) increased relevance of the product resulting from some advantages compared with traditional securitisation; (iii) further standardisation of the product and opening of the market for smaller originators and investors; (iv) potential positive impact on the financial and capital markets, financial stability and the real economy; among others.
  - Cons: (i) it could be perceived as a high-quality label by less sophisticated market players; and (ii) it could lead to less issuance of traditional STS securitisations.

2. Main points (cont.)

- **Criteria for STS synthetic securisation**. The EBA sets out the proposed criteria in order for synthetic securitisations to fall under the STS synthetic securitisation framework, with the aim of ensuring an appropriate level of consistency. The STS synthetic securitisation framework follow the structure of the STS criteria for traditional non-asset backed commercial paper (ABCP) securitisation, that were introduced in the new EU securitisation framework in 2018, and include some specifications. EBA recommends that, for any synthetic securitisation to be eligible for the status of 'STS', it shall comply with the criteria on:
    - Simplicity in the requirements for balance-sheet synthetic transactions regarding the credit risk mitigation rules laid down in CRR, representations and warranties or determining their eligibility for protection under the credit protection agreement establishing the synthetic securitisation, among others.
    - Standardization in the risk retention requirements, the transaction documentation, the identification of reference register or timely resolution of conflicts between investors, among others.
    - Transparency in the data on historical default and loss performance, external verification of the sample of the underlying exposures or environmental performance of assets, among others.
    - Specific to synthetic securitisation: credit protection payments or eligible credit protection agreement, counterparties and collateral, among others.
- **Framework for a differentiated regulatory treatment of STS synthetic securitization**. The EBA recommends a differentiated regulatory treatment between the STS and non-STS balance-sheet synthetic securitization. This differentiated regulatory treatment should consist of an adjustment of the prudential floor for the senior tranche retained by the credit institutions to a level applicable under the STS traditional framework and corresponding adjustments of the risk weights for the senior tranche as applicable under the STS traditional framework. The differentiated regulatory treatment should be subject to the following conditions:
    - The securitisation should meet the requirements on simplicity, standardisation, transparency and the criteria specific to synthetic securitization.
    - The securitisation should meet the criteria under CRR II.
    - The securitisation should be a balance-sheet synthetic securitisation.
    - The position should hold (retained) by the originating credit institution.
    - The position qualifies as the senior securitisation position.

  However, the EBA points out certain concerns on the introduction of a differentiated regulatory treatment of the STS synthetic securitisation at the current stage:
    - Limitations with the data and transactions analysed on the report, concerning the scope, representativeness and limited time horizon of the data, which do not cover the full economic cycle.
    - Limited experience with the STS framework, which entered into force in January 2019.It could lead to a potential overuse of synthetic securitisation and provide an incentive for banks to implement a potential large-scale substitution of regulatory capital through risk mitigation strategies (i.e. RWA reductions), which could result in banks' increased leverage if not properly monitored and supervised.

25/05/2020

- **Report on competent authorities' approaches to tackling market integrity risks associated with dividend arbitrage trading schemes (Cum-Ex)**
- **Action plan on dividend arbitrage trading schemes ("Cum-Ex/Cum-Cum")**

1. Context

In November 2018, EBA and ESMA conducted an inquiry into dividend arbitrage trading schemes (e.g. cum-ex, cum-cum) in order to assess potential threats to the integrity of financial markets and to national budgets; to assess whether there were breaches of either national or Union law; to assess the actions taken by financial supervisors in Member States; among others. In December 2018, the EBA's Board of Supervisors (BoS) discussed the extent to which such schemes are relevant from a supervisory perspective and consequently, the EBA considered that dividend arbitrage trading schemes may be relevant from two specific perspectives: (i) an anti-money laundering and countering the financing of terrorism (AML/CFT) perspective and (ii) the more general governance perspective of prudential supervision. In 2019, EBA decided to carry out two surveys of competent AML/CFT authorities and prudential supervisors. Their aims are to gain an understanding of whether dividend arbitrage trading schemes were treated as tax crimes and to understand how financial institutions' involvement in such schemes complied with the prudential framework.

In this context, EBA has published the **Report on competent authorities' approaches to tackling market integrity risks associated with dividend arbitrage trading schemes** and the **Action plan on dividend arbitrage trading schemes ("Cum-Ex/Cum-Cum")**, with the aim of setting out what competent AML/CFT and prudential authorities should do to mitigate the risks associated with dividend arbitrage trading schemes and posing an action plan to enhance the future framework of prudential and AML requirements covering such schemes.

2. Main points

- **EBA's expectations of AML/CFT and prudential authorities**. The EBA's inquiry concluded that national authorities do not share the same understanding of dividend arbitrage trading schemes and therefore, the EBA set out the following expectations of credit institutions and national authorities under the current regulatory framework:
  - Competent prudential authorities should take information received from AML/CFT supervisors into account when performing their reviews of institutions' internal controls and internal governance arrangements.
  - AML/CFT supervisors should reach out to local tax authorities to establish whether certain dividend arbitrage trading schemes constitute tax crimes, and, if so, inform competent prudential authorities for inspections.
  - Cooperation and information exchange between all relevant authorities and prudential and AML/CFT competent authorities are recommended.
  - Taking a comprehensive view of the risks highlighted by dividend arbitrage trading cases, which may give rise to questions about the adequacy of financial institutions' internal controls, internal governance arrangements and their anti-money laundering systems and controls.
  - Supervisory colleges discussing such schemes with a view to establish whether potential joint supervisory activities in case of concerns should take place.

2. Main points (cont.)

- **Action plan**. The EBA published a 10-point action plan, which seizes on the opportunities afforded by recent legislative changes in the EU Capital Requirements Directive (CRDV) and the EBA's AML/CFT mandate in the EBA Regulation, and which will be implemented in 2020 and 2021. The 10-point action plan comprises:
  - Amend its prudential Guidelines on Internal Governance, in order to ensure that the management body develop, adopt, adhere to and promote high ethical and professional standards.
  - Amend its prudential Guidelines on the Assessment of the Suitability of Members of the Management Body and Key Function Holders in order to ensure that tax offences, including where committed through dividend arbitrage schemes, are considered in the assessment.
  - Amend its prudential Guidelines on Supervisory Review and Evaluation Process (SREP) with regard to the section on governance, in order to include an appropriate reference to tax crimes, such as dividend arbitrage schemes, to reflect the relevant amendments in the guidelines on internal governance and fit and proper assessments.
  - Monitor, in the context of the preparation of the Supervisory Convergence Report due in Q2 2021, how prudential colleges have followed up, in a risk-based approach, on guidance embedded in the 2020 convergence plan.
  - Assess the responses the EBA will receive to its ongoing consultation on its Guidelines on ML/TF risk factors to identify whether the existing references to tax crimes contained in the draft Guidelines are sufficient to address the risks arising from dividend arbitrage trading schemes.
  - Amend its Guidelines on Risk-Based AML/CFT Supervision under AMLD4 to include additional requirements on how AML/CFT competent authorities should, in a risk-based approach, identify, assess and address ML/TF risks associated with tax crimes such as illicit dividend arbitrage schemes.
  - Amend its biennial Opinion on ML/TF Risks under AMLD4, by assessing ML/TF risks associated with tax crimes in greater detail than the previous version the Opinion already did.
  - Continue to allocate, in its ongoing multi-annual programme of staff-led AML/CFT implementation reviews of AML/CFT competent authorities, explicit time to authorities' handling of ML/TF risks associated with tax crimes, where this risk is significant.
  - Monitor discussions in AML/CFT colleges, and intervene actively as necessary, to ensure that AML/CFT colleges for financial institutions that are exposed to significant ML/TF risks associated with tax crimes, address such risks.
  - Carry out an inquiry of the EBA Regulation into the actions taken by financial institutions and national authorities within their competencies to supervise compliance with requirements applicable to dividend arbitrage trading schemes.

3. Next steps

- The 10-point Action plan on dividend arbitrage trading schemes will be **implemented throughout 2020 and 2021**.
- The **EBA** have provided the **following tentative deadlines**:
  - Q4 2020: Report on the functioning of AML/CFT colleges.
  - Q1 2021: Guidelines on internal governance, Guidelines on the assessment of the suitability of members of the management body and key function holders and the Opinion on ML/TF risks.
  - 2Q 2021: the Supervisory Convergence Report, the amended Guidelines on risk-based supervision and the report of implementation reviews of AML/CFT.
  - 4Q 2021: the amended draft on Guidelines Supervisory Review and Evaluation Process (SREP) (some elements may be included in an Opinion on the prudential treatment of ML/TF risks under SREP to be published by Q4 2020)

01/06/2020

Consultation Paper (CP) on Draft Regulatory Technical Standards (RTS) for the contractual recognition of stay powers under Bank Recovery and Resolution Directive (BRRD)

1. Context

Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019 amended Directive 2014/59/EU by introducing, amongst other, certain safeguards in order to enhance effective resolution execution in relation to financial contracts subject to third-country law in the absence of a statutory cross-border recognition framework, which ensures the effectiveness of the contractual recognition of stay powers by a Member State's resolution authority. This amendment also align the BRRD with the relevant international standards for cross-border effectiveness of resolution actions such as the Financial Stability Board's 'Key Attributes of Effective Resolution Regimes for Financial Institutions', and 'Principles for Cross-border Effectiveness of Resolution Actions'.

In this context, the EBA has published a **CP on draft RTS for the contractual recognition of stay powers under BRRD** with aim of complying with the Article 71a(1) of the BRRD, which set up that the EBA shall prepare this RTS to determine the content of the contractual term to be included in financial contracts, so that the parties recognize that the contract may be subject to the exercise of the powers of the resolution authorities to suspend or restrict the rights and obligations established in BRRD.

2. Main points

- **Contents of the contractual term**. The contractual term in a relevant financial contract governed by third country law shall include all of the following terms:
  - Acknowledgement and acceptance by the parties that the contract may be subject to the exercise of certain powers by a resolution authority to suspend or restrict rights and obligations arising from such a contract.
  - Description of the powers of the relevant resolution authority according to the BRRD.
  - Recognition by the parties that they are bound by the effect of an application of the powers and requirements referred in the previous point and by the requirements of exclusion of certain contractual terms in early intervention and resolution. This powers are specifically:
    - The suspension of any payment or delivery obligation.
    - The restriction of enforcement of any security interest.
    - The suspension of any termination right under the contract.
  - Acknowledgement and acceptance by the parties that no other contractual term impairs the effectiveness and enforceability of this contractual terms, and that the contractual term is exhaustive on the matters described therein notwithstanding any other agreements, arrangements or understandings between the counterparties relating to the subject matter of the relevant agreement.
  - Acknowledgement of the parties that such contractual term is subject to the law of a Member State.
- **Impact assessment**. The EBA concludes that it is necessary to specify the conditions to be included in the contract term to avoid the following problems: (i) the lack of definition of the mandatory contents of the contractual term may lead to reduce the effectiveness of the inclusion of the term as regards financial instruments governed by the law of a third country; (ii) the absence of an appropriate level of convergence and uneven playing field between institutions, implying an heterogeneous application in the different jurisdictions.

3. Next steps

- The deadline for submitting comments is the **15th of August 2020**.

01/06/2020

Preliminary analysis of impact of COVID-19 on EU banks

1. Context

The outbreak of COVID-19, which has hit Europe particularly hard, has resulted not only in a huge health crisis, but also in enormous economic challenges. Gross domestic product (GDP) is expected to contract significantly in EU economies and worldwide. Nevertheless, banks entered the COVID-19 crisis in better shape than they did in previous crises. Compared with the Global Financial Crisis in 2008, banks now hold larger capital and liquidity buffers. However, vulnerabilities persist in several areas. Since Q4 2019, profitability levels have remained subdued amidst low interest margins and the challenges for banks to reduce their operating expenses, as many banks do not earn their cost of equity.

In this context, the EBA has published a **Preliminary analysis of impact of COVID-19 on EU banks** mainly based on supervisory reporting data submitted by EU banks until the end of April, although some of the information is previous to that date. The EBA points out that given the uncertainty of the impact from the crisis on the economy and some of the assumptions made, the estimates in this note are preliminary and should be interpreted with caution. Additionally, the EBA has also conducted a sensitivity analysis for the potential impact of a decrease in banks' revenues due to the net interest income (NII) potentially coming under pressure.

2. Main points

- **External environment**. The slowdown in economic activity, which will led to an expected decrease in the EU's GDP, is strongly affecting financial markets. The most affected services subsectors are those related to tourism as well as employment services and food and beverage services, whereas telecommunication and IT services are the least affected subsectors. Public authorities are lifting social distancing restrictions at a very gradual pace. However, in the absence of an effective vaccine, GDP might take much longer than initially expected to return to its pre-COVID level, especially if there are second or further waves of the virus.
- **The EU banking sector before the crisis**. Following the global financial crisis, EU banks improved their risk profile and the asset quality also improved. Banks face the COVID-19 crisis in a better liquidity position not least thanks to the implementation of the liquidity coverage ratio (LCR). In the current crisis, liquidity buffers will be important not only to enable banks to weather the storm, but also to support households and companies through the pandemic and to kick-start the economy as soon as the virus is effectively contained.
- **Operational resilience and contingency measures**. The most urgent concern for banks was to ensure that they could operate unimpeded and provide their essential services:
    - Banks across Europe have enacted their contingency plans to limit the impact of the crisis on business continuity, including the set-up of ad-hoc crisis units. Contingency plans include the introduction of extended remote working for staff and encourage customers to use digital and remote business channels.
    - Advanced digitalisation, increased automation and the use of ICT solutions have contributed considerably to alleviation of the pressure and the impact of the crisis on banks' operations. No major disruptions, outages or ICT security-related incidents clearly linked to the COVID-19 crisis have been reported, and only a small number of smaller incidents.
    - Operational risks remain elevated, and the crisis has exposed some challenges at banks as volumes of some transactions have increased while resources have been temporarily strained. Some of the challenges are related to providing the infrastructure required to enable staff to work remotely and with the outsourcing of support functions.
    - The response of regulators as well as competent and resolution authorities to mitigate the impact of the virus outbreak on the banking sector aimed to support banks' focus on key operations, and to alleviate operational challenges banks face in the crisis. The measures taken and proposed aim to provide relief in three main areas: operational capacities, capital and liquidity, and asset quality.

2. Main points (cont.)

- **Assets' composition and asset quality**. In Q4 2019, EU banks reported EUR 23.7tn of total assets. The two largest components were loans and advances (66%) and debt securities (13%). In 2019, banks continued increasing their exposures towards non-financial corporation (NFCs) and households (+5%), both of which grew significantly more than in previous years.
    - Unsecured exposures might face particular stress. In recent years, banks have significantly increased their exposures towards riskier segments, such as SMEs and consumer credit, however, the composition of loans and advances differs widely across countries.
        - **Uncollateralised portfolios presumably bear higher risk and might suffer a faster asset quality deterioration**, but it remains to be seen how the COVID-19 crisis will affect the value of the collateral underlying collateralised exposures (e.g. real state prices).
        - **The commercial real estate (CRE) segment might also be greatly affected** (e.g. high street shops, hotels or office space). On the other side, other types of retail space might experience rising demand (e.g. warehouses).
        - The increase of financing needs will also result in again **higher levels of indebtedness of households, corporates and sovereigns** in the years to come which reverses the contraction of indebtedness levels seen in recent years.
    - The riskiness of banks' exposures also depends on the sectors of their counterparties. Total NFC exposures account for around 36% of the total loan portfolio of EU banks and, on average, around 57% of banks' NFCs loans and advances (18% of total loans and advances) are towards the most affected sectors.
        - The exposures to the **most affected sectors have a majority of counterparties residing in the European Economic Area (EEA)**. This is particularly high for construction and accommodation and food service activities.
        - Banks' geographical diversification proved helpful during previous crises, and it might be of help again as the magnitude of the economic hit of the pandemic varies across countries. Nonetheless, given the global character of COVID-19, the benefits of **geographical diversification might be much more limited this time**.
    - Sovereign exposures might suffer from valuation effects. As at Q4 2019, the gross carrying amount of general government exposures of EU banks stood at EUR 3.08tn. The largest share of sovereign exposures was measured at amortised cost (54%), followed by fair value through other comprehensive income (FVtOCI, 26 %) and fair value through profit and loss (FVtP&L, 14%, including held for trading).
        - Since variations in the market value of the exposures under FVtOCI and FVtP&L are immediately reflected in equity, **banks' capital levels might be significantly affected in periods of elevated spread volatility**.
        - The impact might be amplified by the fact that **around 45% of sovereign exposures have a maturity of 5 years or more**, which are more vulnerable to interest rate moves than shorter-term exposures.
    - Asset quality for banks will be affected in a material manner from this unprecedented shock. The NPL ratio in Q4 2019 stood at 3.1% with a total NPL volume of EUR 529bn, but the asset quality is heterogeneous across portfolios. Exposures to households have lower NPL ratios (3.3%) than exposures to NFCs (5.4%) and NPL ratios for SMEs, CREs and consumer credit are considerably higher than for large corporates and mortgage loans. Banks' Q1 results show the first signs of deterioration in asset quality and it is expected further material deterioration during the rest of the year. It is clear that only a part of the expected impact on banks' loan loss provisioning has so far been incurred, with a bigger part still to come.
- **Funding and liquidity**. Since the outbreak of the crisis, deposits have been stable and volumes have been largely unaffected. Competent authorities have not reported any unusual outflows of household or NFC deposits since March, although in some cases a temporary spike in cash demand was observed. However, since February 2020, spreads have widened substantially and new unsecured debt issuances have come almost to a halt until mid-April. About 20% of securities issued by banks will mature in the next 6 months, and an additional 10% will mature within 1 year. Tensions have also appeared in interbank and US dollar (USD) funding markets. Under these circumstances, banks have increased significantly their reliance on central bank funding, including swap lines in foreign currencies. It is expected that banks will also make some use of their ample liquidity buffers in the months to come.
- **Profitability**. Banks entered the COVID-19 crisis with very low profitability levels. Lending margins are likely to remain low as a result of central banks' monetary stimulus.
    - New mortgage lending has come to a temporary halt and, however NFC lending is rising, driven also by the drawing of committed credit lines and new lending under public guarantee schemes.
    - Banks might need additional funding if an overall increase in lending volumes takes place, where the cheapest source of which might be central banks.
    - The expected credit quality deterioration will result in an increase in impairments.
    - Branch overcapacity might increase due to the rise of online banking, pushing banks to embark on even more ambitious digitalisation strategies. These can also be favoured by the recent EC proposal to frontload the non-deduction of prudently valued software assets.

2. Main points (cont.)

- **Capital**. Although banks could face significant losses, capital buffers allow banks to provide relevant coverage for the rise in cost of risk, and to maintain their important financing to the real economy. Further, its risk-weighted assets (RWA) have decreased, reflecting banks' deleveraging strategies and efforts to focus their business activities on core markets and portfolios. The relief measures taken by some authorities include the following:
    - Use of the flexibility embedded in existing regulation, allowing banks to cover Pillar 2 Requirement (P2R) with capital instruments other than CET1.
    - Release or reduction of countercyclical buffers (CCyB).
    - Reduction of the systemic risk buffer (SyRB) and the other systemically important institutions (O-SII) buffer.
    - Recommendation to refrain the payment of dividends for the year 2019.

  Once this crisis is over, banks will have to rebuild capital buffers. Given their low market valuations, doing so inorganically might result in a high dilution for existing shareholders.

3. Next steps

- In early **June**, the EBA will publish the results of its **additional Transparency Exercise**, and provide detailed bank-by-bank data.

03/06/2020

Final Report Guidelines on reporting and disclosure of exposures subject to measures applied in response to the COVID-19 crisis

1. Context

The European Union (EU) and Member States have introduced a wide range of measures to support the real economy and the financial sector due to the need to address negative economic consequences of COVID-19 pandemic. In response to these measures, the European Banking Authority (EBA) has clarified the implication of such payment moratoria on the application of prudential rules, including in relation to the application of rules on forbearance and the definition of default and non-performing exposures. However, the lack of sufficient information on the application of these measures, it has generated that the EBA has introduced additional reporting and public disclosure requirements for the institutions for the purposes of supervising and transparency for investors and in the wider public interest.

In this context, the EBA has published a **Final Report Guidelines on reporting and disclosure of exposures subject to measures applied in response to the COVID-19 crisis** which sets out the following reporting and disclosure requirements for: monitoring the use of payment moratoria and the evolution of the credit quality of the exposures subject to such moratoria in accordance with the GL on moratoria; the new loans subject to specific public guarantees set up to mitigate the effects of the COVID-19 crisis; and reporting requirements on other forbearance measures applied in response to COVID-19 crisis.

2. Main points

- **Scope of reporting and disclosure requirements**. These guidelines specify the content and uniform formats to be required by competent authorities when exercising their supervisory powers for:
    - Reporting on exposures that meet the conditions set out in EBA Guidelines on legislative and non-legislative moratoria on loan repayments; the exposures subject to forbearance measures; and the newly originated exposures subject to public guarantee schemes introduced in Member States (all applied in the light of the COVID-19 crisis)
    - Disclosure of the aforementioned exposures set out in EBA Guidelines on legislative and non-legislative moratoria on loan repayments; and the newly originated exposures subject to public guarantee schemes introduced in Member States (both in response to the COVID-19 crisis)

These guidelines should be applied at the **individual, sub-consolidated and consolidated level**.

- **Reporting reference and remittance dates**. Credit institutions should report the data set out in the previous point to the 7 templates (4 reporting templates and 3 disclosure templates) and in accordance with the instructions set out in Annexes 1 and 2 from this document. On the one hand, the quarterly reporting reference dates are on 31 March, 30 June, 30 September and 31 December; and the quarterly reporting remittance dates are on 12 May, 11 August, 11 November and 11 February. On the other hand, the disclosure templates will be sent every six months.
- **Proportionality in the application of the requirements**. To ensure the proportional application of the reporting and disclosure requirements set out in these guidelines, competent authorities should consider whether they should apply the reporting and disclosure requirements, taking into account the size, nature, scope, complexity of activities and risk profile of institutions under their remit, to the specificities of their banking sector and to the impact of the COVID-19 crisis.
- **Technical package**: to facilitate reporting on the basis of these guidelines, the EBA will provide technical package, covering validation rules, the data point model (DPM) and the XBRL taxonomy and will fully integrate the new reporting into the EBA reporting framework.

3. Next steps

- The first reporting reference date and the disclosure reference date will be **30 June 2020**.
- From the first reference date, the **reporting** should be performed on a **quarterly** basis and for an expected period of 18 months, and the **disclosure** should be performed **semi-annually** on 30 June and 31 December.
- The EBA will develop and publish accompanying data validation rules (VRs), data point model (DPM) that will be used to generate an associated XBRL taxonomy in June 2020.

08/06/2020

Consultation Paper (CP) on Draft Regulatory Technical Standards (RTS) on own funds and eligible liabilities

1. Context

In the course of the adoption of the 'Risk Reduction Measures Package' by European legislators in May 2019, CRR II has updated the own funds framework with certain targeted adjustments and to a larger extent with focus on the regime of supervisory prior permission for the reduction of own funds. Furthermore, the Delegated Regulation (EU) No 241/2014 specifies the eligibility criteria for own funds ('RTS on own funds'). As the eligibility criteria has been amended, albeit to a limited extent, the RTS on own funds need to be amended too in order to reflect those changes.

In this context, the EBA has published a **Consultation Paper (CP) on draft Regulatory Technical Standards (RTS) on own funds and eligible liabilities** which main objective is to adapt the existing RTS on own funds to the new provisions introduced with CRR II. In particular, this draft RTS updates the current own funds requirements, defines harmonise criteria for qualifying as eligible liabilities and amends the rules relating to the supervisory permission for reducing own funds and eligible liabilities instruments.

2. Main points

- **CET 1, AT1 and eligible liabilities**. This draft RTS fully aligns the RTS on eligible liabilities for the purpose of indirect funding with the one on own funds and the eligibility criteria regarding the form and nature of incentives to redeem for eligibility liabilities.
- **Indirect holding arising from index holdings**. With respect to the extent of conservatism required in estimates used as an alternative to the calculation of underlying exposures for indirect holdings arising from index holdings and the meaning of operationally burdensome for the institution to monitor those underlying exposures this draft RTS have inserted references to the requirements for own funds and eligible liabilities for G-SIIs to emphasize that only G-SIIs have to deduct eligible liabilities holdings.
- **Supervisory permission for reducing own funds**.
    - The meaning 'of sustainable for the income capacity of the institution' for the purposes of supervisory permission to reduce own funds, now also covers the replacement of share premium accounts.
    - With regard to the process requirements including the limits and procedures for an application by an institution to reduce own funds, slight amendments are applied in order to cater for the reduction or distribution of share premium accounts. Furthermore, regardless of the notion of sufficient certainty, institutions in such case have to deduct the predetermined amount for which the general prior permission is granted from the moment the competent authority's (CA) permission is obtained.
    - The provision regarding permission for immaterial amounts to be called redeemed or repurchased is no longer needed.
    - With regard to the content of the application and additional information to be submitted when applying for a general prior permission for reducing own funds and eligible liabilities, this draft RTS specifies the type of information institutions have to provide in a detailed and cross referenced manner to the different prudential requirements set out in the CRR, CRD and BRRD, reflecting the changes introduced by the European Banking Package.
    - With respect of the timing of the application to be submitted by the institution and the time period for processing a prior permission, this draft RTS suggest to raise the minimum time period that an application needs to be submitted in advance from three to four months.

2. Main points (cont.)

- **Supervisory permission for reducing eligible liabilities instruments**.
    - With respect to the conditions for an institution to seek permission to replace instrument established for own funds, this draft RTS fully aligns the terms for eligibility liabilities and sets out that the replacement should be at terms that are sustainable for the income capacity of the institution.
    - With regard to process requirements for an application by an institution to reduce eligible liabilities instruments, this draft RTS establishes that: i) calls, redemptions, repayments and repurchases of eligible liabilities instruments shall not be announced to holders of the instruments before the institution has obtained the prior permission of the resolution authority, ii) once the prior permission of the resolution authority has been obtained, the institution shall deduct the corresponding amounts, iii) in the case of a general prior permission, the predetermined amount for which the resolution authority has given its permission shall be deducted from the moment the authorization is granted.
    - This draft RTS introduces a system of limits for the reduction of eligible liabilities that is broadly similar in design and calibration as for own funds, with some adjustments (e.g. maximum overall limit of 3% of the total amount of outstanding eligible liabilities instruments).
    - This draft RTS sets out the content of the application and additional information to be submitted by the institution to obtain the prior permission of the RA.
    - With regard to the timing of the application to be submitted by the institution and processing of the application by the RA, this draft RTS suggests the minimum time period of four months before announcement to noteholders.
    - This draft RTS specifies the process of cooperation between the CA and the RA setting out the core elements of that cooperation process while leaving to authorities some flexibility to tailor the process to their internal procedures and specific circumstances.
    - The temporary waiver from deduction from own funds has been amended to open the possibility to temporarily waive the application of deduction requirements also for eligible liabilities instruments.

3. Next steps

- Comments to this CP should be submitted by **31th August, 2020**.

08/06/2020
Guidelines on loan origination and monitoring

1. Context

As part of the EU's response to cope with the high level of non-performing exposures, the Council of the European Union defined an Action Plan to tackle non-performing loans (NPLs) in July 2017, which invited the EBA to issue detailed guidelines on banks loan origination, monitoring and internal governance. Within the framework of the Council's Action Plan, the EBA has already published Guidelines on management of non-performing and forborne exposures, Guidelines on disclosures of nonperforming and forborne exposures and developed non-performing loan (NPL) transaction templates. These previous initiatives aim to tackle problems around loans once they become non-performing.

In this context, after the publication of the consultation paper in June 2019, the EBA has published **Guidelines on loan origination and monitoring** with the aim to improve institutions' practices and associated governance arrangements, processes and mechanisms in relation to credit granting, in order to ensure that institutions have robust and prudent standards for credit risk taking, management and monitoring, and that newly originated loans are of high credit quality. The guidelines also aim to ensure that the institutions' practices are aligned with consumer protection rules and respect fair treatment of consumers. Finally, these guidelines apply to all subsidiaries of European financial institutions even if they are located outside the EU.

2. Main points

- **Internal governance for credit granting and monitoring**. The EBA set out provisions on credit risk governance & culture, credit risk appetite, strategy and limits. It also focuses on credit risk policies and procedures (e.g. anti-money laundering and counter-terrorist financing (AML-CFT) policies and leveraged transactions) and credit decision making. Major changes set out in these guidelines are the institutions should:
  - Set escalation thresholds of risk appetite by management body to ensure that the remuneration framework is aligned with credit risk appetite.
  - Take into account principles of responsible lending within their credit risk policies and procedures. In particular:
    - Consider the **specific situation of a borrower**.
    - **Design credit products** that are offered to consumers in a responsible way.
  - Ensure that the credit-granting criteria are not inducing undue hardship and over-indebtedness for the borrowers and their households.
  - Specify the use of any automated models in the creditworthiness assessment and credit decision-making processes in a way that is appropriate to the size, nature and complexity of the credit facility and the types of borrowers.
  - Set out appropriate governance arrangements for the design and use of such models and the management of the associated model risk.
  - The allocation of credit decision-makers to the organisational and business structure should reflect the cascading credit risk appetite and limits within an organisation and be based on objective criteria, including risk indicators.
  - Define their risk appetite for syndicating leveraged transactions and derive a comprehensive limit framework.
  - Considerate ESG factors and associated risks on the financial conditions of borrowers, and in particular the potential impact of environmental factors and climate change, in their credit risk appetite, policies and procedures.
  - Ensure the establishment of an appropriate remuneration policy that ensures the alignment with the compliance with the risk appetite framework, the credit quality of operations and avoiding the existence of a conflict of interest.

2. Main points (cont.)

- **Loan origination procedures**. Institutions and creditors should have sufficient, accurate and up-to-date information and data necessary to assess the borrower's creditworthiness and risk profile before concluding a loan agreement.
    - Institutions and creditors can consider the use of specific information, data items and evidence suggested in these guidelines to gather the needed information for the creditworthiness assessment.
    - Specific policies are required for the prevention of money laundering and terrorist financing, compliance with ESG factors, leveraged transactions and sustainable financing.
    - Institutions must ensure that the models used in the credit granting processes must be explainable and interpretable.
    - The information requirements on the assessment of the solvency of operations are no longer prescriptive (they are a reference). Additionally, some modifications to these requirements have been included such as:
        - **New metrics are included**: sources of repayment capacity, composition of households and dependents, expenses for servicing of financial commitments and regular expenses.
        - **Differences between micro & small enterprises and medium-size & large enterprises**. Requirements are adapted according to the type and size of the borrower (e.g. sensitive analysis applies only for medium-size and large enterprises).
- **Pricing**. The EBA notes that pricing frameworks should reflect institutions' credit risk appetite and business strategies, including profitability and risk perspective. Major changes comprise that institutions should:
    - Pricing frameworks should reflect institutions' credit risk appetite and business strategies, including profitability and risk perspective.
    - Set up a pricing framework according to the type of portfolio/customer: (i) for micro and small enterprises the price should be set at the portfolio and product level; and (ii) for medium and large enterprises the price should be set at the transaction/loan level.
    - Consider differentiating between their pricing frameworks, depending on the types of loans and borrowers. For consumers and micro and small enterprises, the pricing should be more portfolio and product based, whereas for medium-sized and large enterprises the pricing should be more transaction and loan specific.
    - Set out specific approaches to pricing promotional loans, when risk-based and performance considerations specified in this section do not fully apply.
    - Include as a part of the pricing the cost of capital, cost of financing, operational and administrative cost, cost of credit risk, any other associated costs and, new according to the draft Guide, the consideration of competition and market conditions.
    - Regarding the monitoring process, all material transactions below costs should be identified and properly justified, in line with the policies and procedures established by the institution.
- **Valuation of immovable and movable property**. When a credit facility is secured by an immovable or movable property collateral, institutions should ensure that the valuation of the collateral is carried out accurately and based on its internal policies and procedures. Among the changes it is highlighted that institutions must:
    - Have a procedure for the valuation, monitoring and review of the value by type of guarantee.
    - Take into account ESG factors affecting the value of the collateral (e.g. the energy efficiency of buildings).
    - When institutions use external valuers, they should establish a panel of accepted external valuers to ensure that they have relevant expertise in relevant segments of the property sector. These institutions are responsible of the setting up and maintenance of this panel.
    - Ensure an adequate rotation of valuers. although the final version of the Guide set out that there is a flexible limitation of 2 appraisals to carry out the rotation of appraisers and the entity is able to establish the limit.
    - The EBA has further revised the guidelines to allow the use of advanced statistical models for the valuation of immovable property collateral at the point of origination, according to the requirements of the CRR/CRD and Mortgage Credit Directive (MCD).

2. Main points (cont.)

- **Monitoring framework**. Institutions should have a robust and effective monitoring framework, supported by an adequate data infrastructure, to ensure that information regarding their credit risk exposures, borrowers and collateral is relevant and up to date, and that the external reporting is reliable, complete, up to date and timely. These guidelines incorporate the following requirements:
    - Proportionality criteria have been included, therefore individual monitoring and in particular, regular credit reviews and qualitative monitoring factors apply to corporate borrowers (medium and large companies). In general, it is required to monitor the consumers, micro and small businesses at the portfolio level.
    - Sensitivity analysis is required in credit reviews for medium and large enterprises; however, the requirement of monitoring the stress testing has been eliminated in these guidelines, as the EBA Guidelines on stress testing are regulated.
    - In addition to monitoring credit and financial metrics, institutions should take into account information related to qualitative factors that could have a relevant influence on the repayment of a loan.
    - Institutions engaged in syndicating leveraged transactions should implement internal standards and monitoring functions for these activities and establish a dedicated framework to deal with failed syndications in terms of holding strategy, booking and accounting practices, regulatory classification and subsequent capital requirements calculation (i.e. transaction that were not syndicated within 90 days following the commitment date).
    - Performing regular credit reviews of borrowers that are at least medium-sized or large enterprises, with a view to identifying any changes in their risk profile, financial position or creditworthiness compared with the criteria at the point of loan origination.
    - High risk operations are aligned with the article 128 of CRR2. No specific KRIs are required to identify them.
    - Monitoring concentration measures against the values specified in their credit risk appetite, policies and procedures, including, where relevant, by product, geography, industry, collateral features, and quality of portfolios, sub-portfolios and exposures.
- **Other aspects to consider**. In the final version of these guidelines, EBA has clarified the following aspects:
    - Application of the guidelines at the subsidiary level for European financial institutions, including those are located outside the European Union.
    - Exclusion of refinanced/restructured transactions from the scope of these guidelines.

3. Next steps

- The Guidelines will apply from **30 June 2021**. However, institutions will benefit from a series of transitional arrangements:
    - The application of the guidelines to the already existing loans and advances that require renegotiation or contractual changes with the borrowers will apply from 30 June 2022.
    - If institutions do not have all the relevant information and data to be used for the monitoring of existing borrowers or credit facilities granted before the application date, they should collect missing information and data until 30 June 2024.
- The deadline for competent authorities to report whether they comply with the guidelines will be **2 months after the publication** of the official EU languages translations.

11/06/2020

Spring 2020 EU-wide transparency exercise

1. Context

Since 2011, the EBA has been conducting transparency exercises at the EU-wide level on an annual basis. The transparency exercise is part of the EBA's ongoing efforts to foster transparency and market discipline in the EU financial market, and complements banks' own Pillar 3 disclosures, as laid down in Capital requirements directive (CRD). In 2020, following the postponement of the EU-wide stress test exercise, the EBA decided to release two Transparency exercises, one in late Spring and one in late Autumn, with the aim to inform the public on the conditions of the EU banking sector at the start of the COVID-19 crisis and the impact of the crisis in the first half of 2020.

In this context, the EBA has published the **Spring 2020 EU-wide transparency exercise** with the aim of providing market participants with updated information on banks' exposures and asset quality as of 31 December 2019, prior to the start of the crisis. The data included in the Spring 2020 exercise can serve a benchmark on the condition of the banking sector before the pandemic crisis and as a starting point for the analysis of the crisis impact. The direct impact from Covid-19 on the banking sector will be more evident with the disclosure of 2020 data in the next Transparency exercises.

2. Main points

- **General aspects**. The EBA has developed a set of practical tools to help users navigate through the Spring 2020 EU-wide transparency data. These include interactive maps and aggregation tools, which allows users visualizing and analysis data by country and by bank through maps, as well as a complete dataset in CSV format, which can be imported into any analytical software for analysis purposes. The transparency dataset itself is stored in four different CSV files and shows all the bank-by-bank data contained in the transparency templates.
    - Sample of banks:127 banks from 27 countries of the EU and the European Economic Area (EEA). Based on total assets, this sample covers about 74% of the EU/EEA banking sector.
    - Reference date for the data: September 2019 and December 2019.
    - The templates cover the following areas: capital, leverage ratio, risk exposure amounts, profit and losses, assets, liabilities, market risk, credit risk, exposures to sovereign, non-performing exposures, forborne exposures and Breakdown of loans and advances to non-financial corporation.
- **Results**. The data confirms the EU banking sector entered the crisis with solid capital positions and improved asset quality, but also shows the significant dispersion across banks. The results of the main indicators of institutions in Europe are:

Overview of key figures

Reference date	CET1 ratio		Leverage ratio		NPL ratio	Coverage ratio for NPL	NII to total operating income	Cost to income ratio
	Transit.[1]	Fully-loaded[2]	Transit.[1]	Fully Phased-in[3]				
Sep. 2019	14.6%	14.4%	5.4%	5.2%	2.9%	44.6%	58.2%	63.3%
Dec. 2019	**15.1%**	**14.8%**	**5.6%**	**5.5%**	**2.7%**	**44.7%**	**58.4%**	**64.0%**

[1] Transitional definition (of Tier 1) — Data of EU/EEA banks

[2] Fully loaded definition

[3] Fully phased-in definition of Tier 1

2. Main points (cont.)

- Capital position. The EU banks reported increasing capital ratios in 2019. The EU weighted average CET1 fully loaded capital ratio was at 14.8% as of Q4 2019, around 40bps higher than Q3 2019. The trend was supported by higher capital, but also contracting risk exposure amounts (REA). As of December 2019, 75% of the banks reported a CET1 fully loaded capital ratio above 13.4% and all banks reported a ratio above 11%, well above the regulatory requirements.
- Leverage ratio. The EU weighted fully phased-in leverage ratio stood at 5.5%. The leverage ratio increased by 30bps compared to the previous quarter, driven by rising capital and declining exposures. The lowest reported leverage ratio was 4.7% at country level (Denmark), and 1.6% at bank level (Kommuninvest Group of Sweeden).
- NPL ratio. The asset quality of EU banks has been on an improving trend over the last few years. As of Q4 2019 the EU weighted average NPL ratio declined to 2.7%, 20bps lower than in Q3 2019. The Q4 2019 ratio was the lowest since the EBA introduced a harmonised definition of NPLs across European countries. Dispersion in the NPL ratio across countries remained wide, with few banks still reporting double-digit ratios, although in the last quarter the interquartile range compressed by 80 bps, to 3.1%. By countries, Greece remained as the country with the highest NPL ratio (35.2%), followed by Cyprus (19.3%) and Bulgaria (18.2%), however these countries have also improved their situation since the last Transparency exercise (e.g. Greece NPL ratio is 220bps lower than in Q3 2019). On the other hand, the rest of countries are below the 8% with the best records in Sweden (0.5%), Germany (1.3%) and the UK (1.3%).
- Coverage ratio for NPL. This ratio remains stable at 44.7%, compared to 44.6% in September 2019. However this ratio has decreased in the last years (e.g. 45.97% in June 2018) with its lower record in the Netherlands (25.5%) and Ireland (27.0%). On the other hand, Hungary (67.4%), Slovenia (64.5%) and Poland (60.7%) have the highest records.
- Net interest income (NII) to total operating income. The NII to total operating income has remained stable in Q4 2019, increasing by 20bps. Luxembourg (30.2%) has the lowest ratio, while Netherlands (77.6%) has the highest, although in the last quarter of 2019 descended by 140bps.
- Cost to income ratio. The cost to income ratio has increased 70bps to 64% which reflects an improvement on the banks operational costs and incomes. However, there is a great difference between countries: Luxembourg (88.2%) and Germany (84.4%) vs. Lithuania (35.3%) and Norway (42.6%).
- Breakdown of loans and advances to Non-Financial Corporations. The most significant changes for this year's Transparency exercise derive from the disclosure of two additional templates, disclosing information related to liabilities and exposures towards industry sectors. Among the most significant sectors it should be highlighted the real state activities (25%), manufacturing (16%) and wholesale and retail trade (13%) as the most important ones.
- Assets and liabilities composition. Among the assets composition in the EU, the financial assets at amortised cost accounts for 61.2% and the financial assets held for trading for 14.3%. On the liabilities composition side, the financial liabilities measured at amortised cost & non-trading non-derivative financial liabilities measured at a cost-based method accounts for 79%.

16/06/2020
Consultation Paper (CP) Draft Regulatory Technical Standards (RTS) on the calculation of the stress scenario risk measure under Article 325bk(3) of Regulation (EU) No 575/2013 (Capital Requirements Regulation 2 - CRR2)

1. Context

In November 2016, the European Commission proposed the amendments to the Capital Requirements Regulation (CRR), which required that institutions shall calculate the stress scenario risk measure (SSRM, Stress Scenario Risk Measure) for all the non-modellable risk factors (NMRF, Non-Modellable Risk Factors) of the trading book positions in a given portfolio. In this line, the publication of these amendments included to CRR in May 2019, setting up a mandate to the EBA to develop draft Regulatory Technical Standards (RTS, Regulatory Technical Standards) to specify how to calculate the 'extreme scenario of future shock' and how to apply it to the NMRF to form the stress scenario risk measure. On the other hand, in December 2017, the EBA published a Discussion Paper (DP) on the EU implementation of market risk and counterparty credit risk revised standards. Considering the feedback received on the discussion paper, and in light of the final international standards, the EBA launched in July 2019 a data collection exercise presenting several SSRM calculation method variants.

In this context, the EBA has published the **Consultation Paper (CP) Draft Regulatory Technical Standards (RTS) on the calculation of the stress scenario risk measure** with the aim of setting out a clear methodology is deemed necessary to ensure a level playing field among institutions in the European Union. In particular, these draft RTS set out the methodologies that institutions are required to use for the purpose of determining the extreme scenario of future shock that, when applied to the NMRF, provides the SSRM. This CP identify two over-arching approaches, although only one of the two will be kept after consultation, that may be used by institutions for determining an extreme scenario of future shock.

2. Main points

- **Overarching approaches for determining the extreme scenario of future shock and determination of the stress period for the NMRF**. The EBA proposes two different overarching approaches that could be implemented for determining the SSRM corresponding to an extreme scenario of future shock as well as how to identify the relevant stress period at risk class level and quarterly basis under each option:
    - Option A: determination of the <u>stress scenario risk measure directly from the stress period</u>.
    - Option B: <u>rescaling a shock calibrated on the current period</u> to obtain a shock calibrated on the stress period. In this case, the 'Methodology S – the stepwise method is applied.

  Both options imply that the institution calculates the SSRM as the loss occurring when the extreme scenario of future shock is applied to the NMRF. Also in this case, such SSRM is then rescaled to reflect the liquidity horizons of the NMRF directly in the aggregation formula set out in these draft RTS.
- **Determination of the extreme scenario of the shock**. Institutions are required to determine a scenario of future shock by applying one of the two methodologies proposed, which have two variants for each methodology depending on whether the institution calculates the stress scenario risk measure for a single NMRF or for the NMRF belonging to a non-modellable bucket.
    - <u>Methodology D – Direct method for future shock</u>: the direct method requires institutions to derive the scenario of future shock by directly calculating the expected shortfall of the portfolio losses.
    - <u>Methodology S - Stepwise method for future shock</u>: the stepwise method requires institutions to determine the scenario of future shock by steps.
- **Regulatory extreme scenario of future shock that institution may use (or may be required to use) when unable to develop an extreme scenario of future shock**. In this case, the competent authority may require the institution to consider the maximum loss that may occur due to a change in the as the stress scenario risk measure for that NMRF. Where such maximum loss does not take a finite value, then institutions shall use an approach using quantitative and qualitative information available to determine a prudent value of the loss that can occur due to a change in the value of the NMRF. Such loss must be determined targeting a level of certainty equal to 99.95% (i.e. it cannot be exceeded in the 99.95% of the cases on a 10 business day horizon).

2. Main points (cont.)

- **Circumstances under which institutions may calculate a SSRM for more than one NMRF**. These draft RTS set out that institutions may calculate a unique SSRM for more than one NMRF if those risk factors belong to the same regulatory bucket and the institutions use the regulatory bucketing approach for assessing the modellability of those risk factors.
- **Aggregation of the stress scenario risk measures**. These draft RTS propose an aggregation formula that aims at capturing the following effects:
  - The non-linearity in the loss function for NMRF for which the institution identified the extreme scenario of future shock using the stepwise method. However, when losses grow faster than linearly, the expected shortfall of losses for varying is higher than the loss of the expected shortfall, such non-linear effects should be captured in the aggregation formula.
  - The uncertainty due to the lower observability of non-modellable risk factors, statistical estimation error and the uncertainty in the underlying distribution for NMRF. It should be noted that where the institution applies the stepwise method such uncertainty is already captured where identifying the extreme scenario of future shock; accordingly, such effect has to be captured in the aggregation formula only for risk factors where the extreme scenario of future shock has been identified applying the direct method.
  - The liquidity horizons of the relevant NMRF since the general methodology has been designed to get a 10-days SSRM.
  - The correlation among NMRF.

3. Next steps

- Comments to this CP should be submitted by **4 September 2020**.

17/06/2020
Consultation Paper (CP) on Draft Regulatory Technical Standards (RTS) on the prudential treatment of software assets

1. Context

As part of the Risk Reduction Measures (RRM) package adopted by the European legislators, the deductions from Common Equity Tier 1 (CET 1) items have been amended, introducing, inter alia, an exemption from the deduction of intangible assets in case of “prudently valued software assets, the value of which is not negatively affected by resolution, insolvency or liquidation of the institutions”.

In this context, the EBA has published a **Consultation Paper (CP) on Draft Regulatory Technical Standards (RTS) on the prudential treatment of software assets** which specifies the application of the exemption to the deduction of intangible assets from CET 1 and the materiality of the negative effects on the value which do not cause prudential concerns. In this sense, the EBA aimed at achieving an appropriate balance between the need to maintain a certain margin of conservatism/prudence in the treatment of software for prudential purposes, and the acknowledgment of the relevance of software assets from a business and economic perspective, in a context of increasing digital environment.

2. Main points

- **Prudential treatment of software assets based on their amortisation**. This draft RTS proposes an approach developed based on prudential amortization. Under this approach, the positive difference between the prudential and the accounting accumulated amortization would be fully deducted from CET 1 capital, while the residual portion of the carrying amount of software would be subject to a 100%risk-weighted. Furthermore, this approach would appropriately take into account the manner the recoverable value of software assets is negatively affected over time. The useful life of software estimated for accounting purposes should be shorter than the prudential amortization period. In this sense, the calibration of the prudential amortization period is proposed to be set at 2 years. Institutions shall calculate the prudential amortization of software assets by multiplying the result derived from the calculation of the two following points:
    - The amount at which the software assets have been initially recognised in the balance sheet of the instituion in accordance with the applicable accounting framework, divided by the number of calendar days of a period that shall not exceed the lower of:
        - The **useful life** of the respective software assets estimated for accounting purposes;
        - **2 years** (the start date from which the two years begin to run will be clarified in the final RTS).
    - The number of calendar days elapsed since the date of the initial recognition of the software assets on the balance sheet under the applicable accounting framework, regardless of the date on which the software assets would be available for use and would begin to be amortised for accounting purposes, or from the date on which the software assets would be available for use and would begin to be amortised for accounting purposes; and up to the end of the useful life estimated.
- **Supervision**. This draft RTS covers a number of areas where a close scrutiny will be warranted by regulators, supervisors and external auditors, as a change in the current treatment might affect the accounting practices currently used by the supervised institutions and to what extent this would have an impact on the regulatory metrics. In this regard, potential areas to be monitored deal with the practices adopted for:
    - The capitalization of the costs related to internally generated software.
    - The estimation of the expected useful life and the amortization methodology of software assets.
    - The treatment of software assets acquired as part of business combinations.

3. Next steps

- Comments to this CP shall be submitted by **9 July 2020**.

22/06/2020

- **EBA Roadmap on Investment Firms**
- **CP on draft RTS prudential requirements for investment firms / EBA data collection for investment firms - Instructions / EBA data collection for investment firms – Template**
- **CP on draft ITS on reporting and disclosures for investment firms and draft RTS on the monitoring of information related to the thresholds for credit institutions reporting requirements for investment firms / Annexes**
- **CP on draft RTS on instruments for investment firms remuneration**
- **CP on draft RTS on pay out in instruments for variable remuneration under IFD**

1. Context

On 5 December 2019, the European Parliament and the Council published the Investment Firm Directive (IFD) and Investment Firm Regulation (IFR) which separates the prudential treatment of investment firms (IFs) and credit institutions (CIs) and will be applicable 18 months after their entry into force. In the IFD/IFR, a significant number of mandates has been given to the EBA, often in consultation with the European Securities and Markets Authority (ESMA), which has direct implications for the implementation of the framework.

In this context, the EBA has published its **roadmap for the implementation of the new regulatory framework** for IF and launched **consultation papers (CP)** on its first set of regulatory deliverables on **prudential**, **reporting**, **disclosures** and **remuneration requirements**, with the aim to strength the supervision, which will rely more directly on the risks faced by the clients and the investment firms themselves.

2. Main points

<u>EBA Roadmap on Investment Firms</u>

- **Roadmap for the implementation of the IFs new regulatory framework**. The EBA mandates have been grouped into the following thematic areas:
    - <u>Thresholds and criteria for IFs to be subject to the CRR</u>. The IFD and IFR include mandates concerning IFs' transition to the prudential status of CI, to provide clear guidance to competent authorities (CAs) on assessing the information to be provided in an application to become a CI and to provide the scope and methodology for the calculation of the threshold beyond which IFs are required to apply for CI authorization.
    - <u>Capital requirements and composition</u>. Mandates concerning the elements needed for the calculation of the capital requirements for Ifs include, among others, a measurement methodology for each of the k-factors as well as supplementary clarification concerning some of the associated notions.
    - <u>Reporting and disclosure</u>. IFs will be required to report to the CAs on their compliance with the prudential framework, specifically in terms of own funds, level of minimum capital, concentration risk, liquidity requirements, level of activity in respect of small and non-interconnected Ifs and the reporting requirements for the purposes of the thresholds that apply to certain IFs. Furthermore, IFs will be subject to disclosure requirements too, in particular, regarding their capital resources, requirements, remuneration policies and practices, and governance standards.
    - <u>Remuneration and governance</u>. The key objectives of the EBA's strategy in the areas of governance and remuneration are, first, to ensure a comprehensive framework for IFs within the EU, and, second, to ensure, when possible, cross-sectoral consistency between the governance and remuneration framework under the IFD and the CRD, also taking into account the requirements set out within the Alternative Investment Fund Managers Directive (AIFMD) and the Undertakings for Collective Investment in Transferable Securities Directive (UCITS) , as mandated within the IFD.
    - <u>Supervisory convergence and the supervisory review process</u>. The EBA's strategy in terms of policy in these areas includes to provide policy products that are fit for purpose for the day-to-day work of CAs in order to facilitate their application, to ensure a consistent and proportionate application of Pillar 2 methodologies across the Union, and to ensure, when possible, cross-sectorial consistency between supervisory cooperation, the SREP and the Pillar 2 framework under the CRD and the IFD.
    - <u>Environmental, social and governance (ESG) factors and risks</u>. The EBA will aim to deliver the ESG-related mandates for IFs by exploring the synergies with ongoing work under the revised CRR/CRD package (EBA action plan on sustainable finance) taking into account particularities of IFs. Further, it is planned to align the timeline for delivering the IFR report with the CRR report.

2. Main points (cont.)

CP on draft RTS prudential requirements for IFs

- **Draft RTS on prudential requirements for IFs**. This CP includes a set of draft RTS which cover the following aspects:
  - The first two draft RTS have been developed for the mandates related to the reclassification of certain IFs to CIs:
    - Draft RTS on the information to be provided for the authorization of IFs as CIs,
    - Draft RTS on the calculation of the EUR 30 bn threshold for an IF to be required to apply for a CI authorization.
  - The second group of the mandates related to capital requirements for IFs at solo level:
    - Draft RTS which specifies the calculation of the fixed overheads requirement and to define the notion of a material change.
    - Draft RTS which specifies the methods for measuring the K-factors to the extent they are not already fully detailed in the IFR.
    - Draft RTS which clarifies the notion of the definition of segregated account by setting the criteria for their identification for the purpose of calculating the capital requirement related to holding client money (K-CMH).
    - Draft RTS which specifies adjustments to the K-DTF coefficients in correspondence of stressed market conditions when market experience a period of extreme volatility.
    - Draft RTS to specify the calculation of the amount of the total margin for the calculation of K-CMG and the criteria to avoid regulatory arbitrage in case that approach is used.
    - Draft RTS on the criteria for subjecting certain IF to the CRR.
  - The third mandate relates to the scope and methods of prudential consolidation for IF groups and provides rules for the calculation of the capital requirements in a consolidated situation (Draft RTS on prudential consolidation of IFs groups).

CP on draft ITS on reporting and disclosures requirements and draft RTS on the monitoring of information related to the thresholds for CIs reporting requirements for investment firms

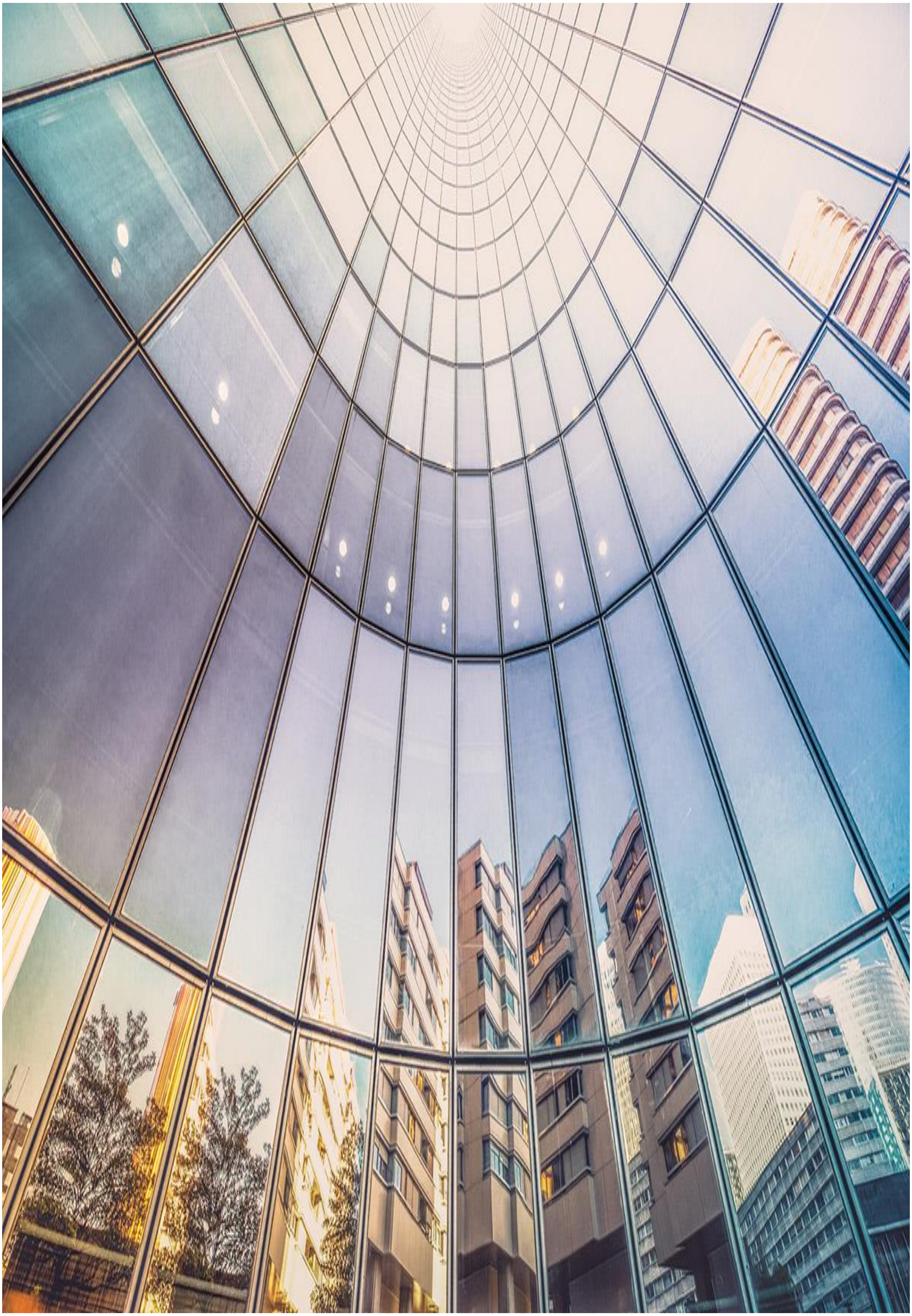
- **Draft ITS on reporting and disclosure requirements**. This draft ITS covers all supervisory reporting and disclosure requirements for IFs under IFR with a proportionate regulatory framework which takes into account the business of IFs, their activity, size and interconnectedness.
- **Draft RTS on the monitoring on information related to the thresholds for CIs reporting requirements for IFs**. This draft RTS includes a set of templates in order to assist CAs in the verification on the information set on the ITS.

CP on draft RTS on instruments for IFs remuneration and draft RTS on pay out in instruments for variable remuneration under IFD

- **Draft RTS on instruments for investment firms remuneration**. This draft RTS set out requirements for AT 1, Tier 2 and other instruments to ensure that the credit quality of the institution is reflected in the instruments and that these instruments are appropriate for the purposes of variable remuneration.
- **Draft RTS on pay out in instruments for variable remuneration under IFD**. This draft RTS main objectives are to harmonise the criteria for the identification of staff whose professional activities have a material impact on the firm's risk profile or assets it manages in order to ensure a consistent approach to the identification of such staff across the EU. The identification criteria are a combination of qualitative and appropriate quantitative criteria that aim at ensuring that a sufficient level of scrutiny by IFs and CAs is applied. Under these draft RTS a staff member will be characterized as "identified staff" if at least one of the criteria is met.

3. Next steps

- Comments to these public consultations shall be submitted by **4 September 2020**.
- The RTS on prudential requirements for investment firms shall apply from **June 2021**.



BANCO DE ESPAÑA
Eurosistema

20/04/2020
Preguntas frecuentes sobre el uso de la flexibilidad prevista en la normativa contable ante el shock causado por el Covid-19

1. Context

The outbreak of the COVID-19 pandemic and the response measures that have been adopted in many countries across the globe and in Spain, are having significant economic consequences. In order to support the financing of the real economy through the entities and thus facilitate their subsequent recovery from the health crisis, European banking regulators and supervisors recommend making appropriate use of the flexibility provided for in the regulatory framework. In this regard, the BoS published an Information Note at the end of March which set out the flexibility measures previously announced by the European Central Bank (ECB), the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA), which focused mainly on allowing credit institutions to use capital and liquidity buffers and on making supervisory time and processes more flexible.

In this context, the BoS has published a series of **FAQ on the use of the flexibility provided in the accounting regulations in response to the shock caused by COVID-19** in order to clarify certain doubts raised by the Information Note published by this same agency on 30 March 2020.

2. Main point

- **Refinancing and renewal in the modification of a credit operation**. The main difference between a refinancing or restructuring and a renewal or renegotiation is that in the first one the entity considers that the borrower has current or foreseeable financial difficulties. This difference has implications in different areas such as public and reserved statements, accounting criteria and prudential capital requirements.
- **Payment holidays**. Payment holidays do not generate any change in the accounting classification of the loan for credit risk. However, they do have implications for the calculation of the maturity of the obligations because the amounts suspended by payment holidays are not considered to be due and therefore are not considered to be overdue.
- **Accounting classification by credit risk of loans granted by the Instituto de Crédito Oficial (ICO) guarantees**. The entity will have to analyse whether the financing with the ICO guarantee is a refinancing or not. In any case, it will be understood that the holder is in financial difficulty if
    - Any of the pre-existing operations is classified as doubtful or has amounts that are more than 30 days overdue.
    - There is a partial default (e.g. a debt removal) of such transactions.
- **Accounting treatment of contractual bilateral modifications**. Financial institutions must analyze whether the modification of the contractual conditions of a transaction agreed bilaterally between an institution and a client is considered a refinancing or a renewal-
- **Factors to be considered when determining the existence of a liquidity problem**. The probability of default during the operation's lifetime should be considered to determine whether there has been a significant increase in credit risk (SICR), in addition to giving greater weight to more stable forecasts based on past experience, while there is no possibility of having more reliable current forecasts. In this regard, the mechanical use of classification factors in the use of existing flexibility in the accounting framework should be avoided.
- **Classification of an operation as standard risk under special surveillance**. Transactions that are 30 days in their due amounts should not automatically be classified as standard risk under special surveillance.
- **Impact of public guarantees on the estimation of expected losses from credit risk**. When calculating the credit loss of operations covered by public guarantees, entities must estimate the cash flows considering all the characteristics of the operation (i.e. among the cash flows, those that would be obtained from the execution of these public guarantees must be taken into account). Consequently, the estimated amount of the coverage of the operations with public guarantee or collateral would be reduced to the extent that the guarantee or collateral covers the eventual lack of cash flows of the borrower.

2. Main points (cont.)

- **Implications of giving greater weight to more stable scenarios in the estimates of expected losses**. As long as the situation of uncertainty and volatility continues, institutions will reflect more stable conditions in their prospective scenarios, in which the effects of the immediate fluctuations generated in an environment subject to continuous changes in the very short term will be mitigated. Subsequently, when the situation begins to stabilise, and reasonable and substantiated information is available, institutions will be able to make more reliable predictions that will be reflected in macroeconomic scenarios and their associated probabilities.
- **Alternative solutions for collective estimates of credit risk coverage**. Institutions may continue to use these alternative solutions without the need to make any additional adjustments. When the BoS has reasonable and substantiated prospective information that allows it to make robust forecasts, it will analyze the calibration of the alternative solutions.
- **Identification of the transactions directly affected by COVID-19**. These transactions must be fully documented and identified in the institution's accounting and risk management systems. In particular, the necessary information must be maintained to know, at all times, the type of measure applied and the evolution of the operations affected, so that their appropriate monitoring and internal control can be carried out.
- **Impact of ECB recommendations in the prudential field on less significant credit institutions**. In the event that the capital of institutions falls below that required to cover the capital conservation buffer and they are required to submit a compliance plan, the BoS will be flexible in processing the approval of such a plan. Furthermore, since the current situation may lead to liquidity pressures, institutions are expected to make use of their liquid asset cushions, even if this means that they may fall below the minimum levels of liquidity coverage (LCR). When this happens, institutions must submit to the supervisor a return-to-compliance plan, which the BoS will process flexibly.

BANCO DE ESPAÑA
Eurosistema

27/04/2020
Boletín Económico 2/2020: Escenarios Macroeconómicos de Referencia para la Economía Española tras el COVID-19

1. Context

The outbreak of the COVID-19 pandemic and the response measures that have been adopted in many countries across the globe and in Spain, are having significant economic consequences. In order to support the financing of the real economy through the entities and thus facilitate their subsequent recovery from the health crisis, European banking regulators and supervisors recommend making appropriate use of the flexibility provided for in the regulatory framework. In this regard, the BoS published a quarterly report on the Spanish economy at the end of March, which analysed the Spanish economic situation at that time, but no monthly indicators were yet available that would make it possible to assess the depth of the economic disturbance, caused by the measures taken to stop the spread of the disease, which was presumed to be very high anyway.

In this context, the BoS has published the **Economic Bulletin 2/2020: Reference Macroeconomic Scenarios for the Spanish Economy after COVID-19**, which develops a set of scenarios for the Spanish economy that take into account different alternative assumptions about the duration of confinement and the persistence of the disturbance suffered. In particular, two methodologies of a different nature have been used: the first is based on an assessment of sectoral production losses as a result of the containment measures of the epidemic, and the second is based on simulations of the main channels of transmission of the economic effects of the pandemic, using the Bank of Spain's Quarterly Model (MTBE).

2. Main points

- **From health crisis to economic crisis**. The health policies taken to slow down the advance of the COVID-19, such as the declaration of the state of alarm, the confinement and the suspension of all non-essential economic activity, have had a great impact on the Spanish economy. However, the economic outlook is surrounded in high uncertainty, mainly due to:
    - An undetermined period of confinement, given that as the pandemic has progressed it has had to be constantly extended.
    - The measures that may need to be taken, once the state of alarm is finalised, both preventively, to avoid the appearance of new sources of infection, and to contain them if they occur.

  Due to these uncertainties, various alternative scenarios have been chosen for the preparation of macroeconomic projections.
- **Reference macroeconomic scenarios built from a supply-side perspective**. These scenarios focus on the downturn in production in different sectors of the economy as an immediate consequence of the measures to contain the epidemic and during the estimated period in which these measures will be in place. The scenarios developed with this approach are the following:
    - Scenario 1: with a containment duration of 8 weeks and almost complete normalisation after the containment, a 6.6% decline in GDP in 2020 is estimated.
    - Scenario 2: with a containment duration of 8 weeks and with almost complete normalisation in the fourth quarter, an 8.7% decline in GDP in 2020 is estimated.
    - Scenario 3: with a containment period of 12 weeks and incomplete normalisation at the end of the year (particularly in the hotel and leisure sectors), a fall in GDP of 13.6% is estimated for 2020.

  This supply-side methodology, which is mainly of an accounting nature, is useful in order to have a reliable estimate of the initial magnitude of the disturbance. However, this approach does not provide a description of subsequent developments beyond the short term, as it does not incorporate explicit modelling of the relationships between economic aggregates.

2. Main points (cont.)

- **Reference macroeconomic scenarios built from a demand perspective**. The second approach to scenario building is based on the performance of simulations with the MTBE, which makes possible to partially address the limitations of the previous approach. MTBE constitutes a schematic description of the main relationships of the Spanish economy, which helps to understand the most important channels of transmission of the disturbance. The scenarios built with the MTBE incorporate a set of disturbances that approximate the effects of the pandemic and are the following:
  - Scenario 1: With a containment duration of 8 weeks and assuming that the measures prevent lasting job losses and business closures, a 6.8% decline in GDP in 2020 is estimated. In this scenario, GDP is expected to recover by 5.5% in 2021 after falling in 2020.
  - Scenario 2: With a containment duration of 8 weeks and assuming that a certain proportion of companies fail to prevent liquidity problems from turning into solvency problems, a 9.5% decline in GDP in 2020 is estimated. In this scenario, GDP is expected to recover by 6.1% in 2021 after falling in 2020.
  - Scenario 3: With a containment period of 12 weeks and assuming that a certain proportion of companies (higher than in scenario 2) fail to prevent liquidity problems from turning into solvency problems, a 12.4% decline in GDP in 2020 is estimated. In this scenario, GDP is projected to recover by 8.5% in 2021 after falling in 2020.

  The different scenarios constructed show that the budgetary cost of the recessionary period caused by the COVID-19 will be very high, specifically the public deficit in 2020 could be in the range of approximately -7% to -11% of GDP. The public debt would be in the range of around 110% to over 120% of GDP this year.

3. Next steps

- These scenarios have a preliminary nature, and are **subject to subsequent revisions** that may be potentially important, depending on the developments observed.

17/06/2020

- **Circular 2/2020 por la que se modifica la Circular 4/2017, a entidades de crédito, sobre normas de información financiera pública y reservada, y modelos de estados financieros**
- **Circular 3/2020 por la que se modifica la Circular 4/2017, a entidades de crédito, sobre normas de información financiera pública y reservada, y modelos de estados financieros**

1. Context

In December 2017, the BoS published Circular 4/2017 on public and confidential financial reporting standards and financial statement formats, which replaced Circular 4/2004, with the aim of adapting the accounting regime for Spanish credit institutions to IFRS 9 and IFRS 15, adopted in the EU in 2016, which modify the accounting criteria for financial instruments and ordinary income, respectively. In this regard, and as a result of the crisis caused by COVID-19, banking regulators and supervisors around the world are recommending that adequate use be made of the flexibility implicit in the regulatory framework, without detracting from the proper identification of the deterioration of operations and a reasonable estimate of their coverage for credit risk. Specifically, the European Banking Authority (EBA) has developed this recommendation in aspects related to the accounting classification of transactions by credit risk and IFRS 9.

In this context, the BoS has issued **Circulars 2/2020 and 3/2020 amending Circular 4/2017 to credit institutions on public and confidential financial reporting standards and financial statement formats**. The first one aims to adapt Circular 4/2017 to the changes in the international regulations on information requirements for credit institutions, and the second one to allow institutions to make greater use of flexibility in credit risk management practices and the accounting of expected credit losses (ECL).

2. Main points

Circular 2/2020 por la que se modifica la Circular 4/2017, a entidades de crédito, sobre normas de información financiera pública y reservada, y modelos de estados financiero

- **Transparency**. This circular introduces the possibility that the individual and consolidated public financial statements disclosure can be carried out by the BoS and not only by the credit institutions' associations.
- **Accounting criteria and reporting**. The circular introduces amendments to comply with the latest international financial reporting standards adopted by the EU. The main changes include:
  - The modification of the business definition to facilitate and simplify its application. This definition serves to determine whether or not the acquisition of a set of assets is treated as a business purchase. If the acquired set is treated as a business, an asset is recognised for goodwill or income for a negative difference:
    - In order to **qualify as a business**, the acquired set must include at least one economic resource and one substantive process that together contribute to the delivery of goods or services to customers.
    - Entities are allowed to choose to perform a **concentration test** to determine, with a simplified analysis, whether or not the acquired set of assets constitutes a business.
- **Individual reserved financial statements**. In order to adapt the financial statements to the entry into force of the EU regulations, certain changes are adopted affecting the individual financial statements reserved FI 1 to FI 45, whose main purpose, among others, is to collect the common financial information that supervised credit institutions have to submit to the European Central Bank (ECB) through the national authorities (NA). The adopted modifications are aimed to:
  - Improve the information sent by institutions on doubtful and restructured exposures and on guarantees granted.
  - Complement the information on operational and administrative expenses and on commission income and expenditure.
  - Incorporate some minor changes in the information available on leases, as a result of the entry into force of IFRS 16.
  - Simplify some information requirements to entities. Those branches in Spain of foreign credit institutions whose head office is located in a Member State of the European Economic Area (EEA) that have decided to apply the criteria for the valuation and provisioning of credit risk used by their head office and have informed the BoS accordingly are exempt from sending the credit risk provisioning statement.

2. Main points (cont.)

- **Reserved consolidated financial statements**. The requirements relating to the information to be reported by consolidable groups of credit institutions on their subsidiaries and joint ventures forming part of the consolidable group are reduced for prudential purposes, modifying the frequency of the balance sheets and income statements included in the activities of the subsidiaries and joint ventures from quarterly to half-yearly, eliminating the statement of equity and reducing the requirements established in the income statement. The statement of supplementary information on subsidiaries and joint ventures is introduced to request, on an annual basis, information on the number of employees of the subsidiaries and joint ventures.

Circular 3/2020 por la que se modifica la Circular 4/2017, a entidades de crédito, sobre normas de información financiera pública y reservada, y modelos de estados financieros

- **Credit risk analysis and provisioning**. This circular amends Annex 9 on the analysis and provisioning of credit risk so that restructured, refinanced or refinancing credit operations do not necessarily have to be classified as normal risk under special surveillance when their classification as doubtful risk is not appropriate. Such transactions may continue to be classified as normal risk provided that the entity justifies not having identified a significant increase in credit risk since its initial recognition.
    - The amendment will be applied prospectively to all restructuring or refinancing, including both transactions carried out before the date of its first application and new transactions carried out after that date.
    - The prospective application of the amendment means that institutions will not have to revise the classification or credit risk provisioning of transactions in financial information for reference dates prior to 30 June 2020 (or, where applicable, 31 March 2020), nor will they have to resubmit the accounting information for those dates or re-elaborate the comparative information for 2019.

3. Next steps

- Circular 2/2020 has **entered in force on 17 June 2020** and the first financial statements to be submitted to the BoS according to the models introduced or modified by this circular will be those corresponding to **30 June 2020**, with certain exceptions.
- Institutions shall adapt, where necessary, their accounting methodologies, procedures and practices to implement the amendments contained in Circular Letter 3/2020 from **30 June 2020** at the latest.

04/05/2020
Real Decreto-ley 15/2020 de medidas urgentes complementarias para apoyar la economía y el empleo

1. Context

As a result of the measures adopted following the declaration of the state of alarm in Spain on 14 March, many economic sectors have been forced to suspend or reduce their activity. This has led to a lack or reduction in income, which may result in the financial inability of self-employed and small and medium-sized enterprises (SMEs) to meet their rental and other business-related obligations, thus putting the continuity of their activities at risk.

In this context, the Spanish government has published **Royal Decree-Law 15/2020 on urgent complementary measures to support the economy and employment**, which contains a new set of measures that it reinforces, complements and extends those previously adopted and focuses on support for businesses and workers in order to respond to the needs for enhanced support arising from the prolongation of this exceptional situation, to continue to protect and support the productive and social fabric, to minimise the impact and to facilitate the recovery of economic activity as soon as this public health emergency begins to subside.

2. Main points

- **Measures to reduce the operating costs of SMEs and self-employed**. The natural or legal person renting a local for professional use may request a moratorium on payment from the owner, which must be accepted by it, as long as no agreement has already been reached between the two parties on a moratorium or reduction of rent. The characteristics of this moratorium are:
    - The owner must be a <u>company, public housing entity or large holder</u>, in all other cases the tenant may opt for other options, such as the use of the deposit.
    - The tenant's request must be made within <u>one month</u> of the entry into force of these regulations.
    - It will be <u>automatically applied</u> and will affect the period of time that the alarm state lasts and the following monthly payments, which can be extended up to a maximum of four months.
    - Deferral of payment shall not entail <u>any penalty or accrual of interest</u> and shall be repaid by dividing the instalments over a period of two years.

  The tenant must additionally meet the following requirements:
    - In the case of a rental contract for the <u>self-employed</u>:
        - To **be affiliated** and in a **situation of registration**, on the date of the declaration of the state of alarm.
        - That the **activity has been suspended** or the **income has dropped by 75%** as a result of the alarm situation.
    - In the case of a rental contract for <u>SMEs</u>:
        - Fulfill the conditions for formulating the simplified **balance sheet** and **statement of changes** in net assets.
        - That the activity **has been suspended** or **the income has dropped by 75%** as a result of the alarm situation.
- **Measures to strengthen business financing**. This Royal Decree also includes measures to strengthen liquidity support and expand its scope:
    - The Institute for the Diversification and Saving of Energy (IDAE) may agree to <u>grant deferrals of the instalments on loans taken out</u>.
    - The Insurance Compensation Consortium may <u>accept in reinsurance the risks assumed by private insurance companies</u> authorized to operate in the credit and surety insurance branches.

2. Main points (cont.)

- **Fiscal measures**.
  - With respect to Corporate Tax, it is allowed, for tax periods commencing on or after 1 January 2020 to exercise the option to make fractionated payments under certain conditions.
  - Also adapted, in proportion to the time period affected by the declaration of the state of alarm in the economic activities, is the calculation of the fractioned payments in the method of objective estimation of Personal Income Tax (IRPF) and the payment on account of the simplified VAT regime.
  - VAT is reduced to 4% on digital books, newspapers and magazines and to 0% for medical devices intended for the public sector.
- **Measures to protect citizens**. New protection measures are adopted:
  - Those workers whose contracts have been terminated during the trial period since 9 March, as well as those who have voluntarily terminated their contracts since 1 March because they had a confirmed job offer that did not materialize as a result of the COVID-19 situation, are considered to be legally unemployed.
  - It is also developed the extension of the contingencies in which the consolidated rights of the pension plans can be made effective.

3. Next steps

- This Royal Decree-Law came into force on **23 April 2020**.

GOBIERNO DE ESPAÑA

25/05/2020
Climate Change and Energy Transition Law Project

1. Context

In 2016, Spain ratified the Paris Agreement on Climate Change, whose overall objectives are to keep the increase in global average temperature below 2°C compared to pre-industrial levels, to ensure the consistency of financial flows with the new development model and to increase the capacity to adapt to the adverse effects of climate change and to promote resilience. In line with the 2030 Agenda for Sustainable Development, in December 2019 the EU published the European Green Deal which sets out a new growth strategy aimed at transforming the EU into a fair and prosperous society with a modern, resource-efficient and competitive economy, and with the final goal of making the EU become the first climate-neutral continent by 2050.

In this context, the Government of Spain has submitted to the Spanish Parliament for debate and eventual approval the **Climate Change and Energy Transition Law Project**, which aims to ensure compliance with the objectives of the Paris Agreement of 2015, facilitate the decarbonisation of the Spanish economy, so as to guarantee the rational and supportive use of resources, to promote adaptation to the impacts of climate change and the implementation of a sustainable development model that generates quality employment.

2. Main points

- **Goals for emission reduction, renewable energy and energy efficiency** by 2030:
    - <u>Reduce the greenhouse gas emissions</u> of the Spanish economy by at least <u>20%</u> with respect to 1990.
    - To achieve a <u>minimum of 35% share of renewable energies</u> in final energy consumption.
    - To achieve an <u>electrical system with at least 70% of its production coming from renewable energies</u>.
    - <u>Improve energy efficiency</u> through the reduction of the primary energy consumption <u>by at least 35%</u> compared to the baseline under EU regulations.

  In addition, by 2050, Spain must achieve climate neutrality and the electrical system must be based exclusively on renewable sources of generation.
- **Renewable energy and energy efficiency**. The integration of renewable technologies into the electrical system (e.g. reversible hydroelectric plants) and the use of energy from renewable sources in the construction field will be promoted.
- **Energy and fuel transition**.
    - <u>No new exploration authorizations, hydrocarbon research permits or concessions for their exploitation will be granted</u> and the application of new tax benefits to energy products of fossil origin must be properly justified (e.g. reasons of social or economic interest, among others).
    - Annual goals will be established for the <u>supply of biofuels in air transport</u> and measures will be taken to promote the use of advanced biofuels and other renewable fuels of non-biological origin.
- **Emission-free mobility and transport**. Measures will be taken to:
    - To achieve a fleet of <u>cars and commercial vehicles</u> without direct emissions of CO_2.
    - <u>Reducing emissions from mobility</u> with measures such as the establishment of a low emission zone for vehicles.
    - Create <u>electric recharging points</u> at certain fuel supply facilities.
    - Gradually reducing emissions generated by the consumption of fossil fuels by <u>marine vessels</u>.
    - The articulation and consolidation of <u>sustainable logistics chains</u>.

2. Main points (cont.)

- **Integration of climate change risk in entities**. Institutions whose securities are admitted to trading on regulated markets, credit institutions, insurance and reinsurance institutions and companies by reason of their size shall submit an annual report assessing the financial impact on the institution of the risks associated with climate change generated by the exposure to climate change of their business, including the risks of the transition to a sustainable economy and the measures taken to address those risks. The content of the report shall include the following aspects:
    - The organization's governance structure, including the role played by its various bodies, in relation to the identification, assessment and management of risks and opportunities related to climate change.
    - The strategic approach of the entities to manage the financial risks associated with climate change and identifying the actions required to mitigate such risks.
    - The actual and potential impacts of climate change risks and opportunities on the organization's activities and strategy, as well as on its financial planning.
    - The processes for identifying, assessing, controlling and managing climate-related risks and how these are integrated into its global business risk analysis and its integration into the organisation's global risk management.
    - The metrics, scenarios and objectives used to assess and manage relevant climate change risks and opportunities.

  Credit institutions will also have to publish the specific goals for decarbonisation of their loan and investment portfolio.
- **Resources and public procurement**. A minimum percentage of public resources allocated to the fight against climate change is set and environmental criteria shall be incorporated in a cross-cutting and mandatory manner in public procurement processes when they are related to the subject matter of the contract.
- **Fair Transition Measures**. Every five years, the Government will approve the Fair Transition Strategy and its objective is to optimize opportunities for activity and employment in the transition to an economy with low greenhouse gas emissions, to identify and adopt measures to ensure equitable and supportive treatment of workers and territories in that transition.

3. Next steps

- The Government of Spain has submitted this law project to the Spanish Parliament and it is pending to be discussed and approved. Once it was approved, it would enter into force **the day after its publication in the Official State Bulletin (BOE)**.
- In the following months, the Spanish Government will approve the **National Integrated Energy and Climate Plan (PNIEC)**, the **National Climate Change Adaptation Plan (PNACC)** and the **2050 Decarbonisation Strategy**.

GOBIERNO DE ESPAÑA

01/06/2020
Real Decreto-ley 19/2020 por el que se adoptan medidas complementarias en materia agraria, científica, económica, de empleo y Seguridad Social y tributarias para paliar los efectos del COVID-19

1. Context

The health crisis resulting from the outbreak of COVID-19 has forced the adoption of public health measures that have altered the normal development of social, economic and productive activities in Spain. In particular, it is noteworthy how the suspension of all non-essential activities and the limitations on the performance of many others have led to a significant increase in short-term unemployment and a reduction in the activity of SMEs and the self-employed. As a result, the Spanish Government has been adopting a series of measures in various fields to alleviate the effects of the economic paralysis since the state of alarm was declared on 14 March.

In this context, the Spanish Government has published **Royal Decree Law 19/2020 adopting complementary measures in the agricultural, scientific, economic, employment and social security and tax fields to alleviate the effects of COVID-19**, which approves various measures such as the payment deferrals for communication services or the submission of the corporate tax when the available annual accounts have been approved. This Royal Decree-Law also incorporates a special regime for moratorium agreements reached between lenders and their customers with the aim of promoting the application of measures and agreements to defer credit and loan payments with a broader scope than that initially established.

2. Main points

- **Payment deferrals in the communications service**. Electronic communications operators must grant their customers, on request, payment by instalments and, consequently, the deferral of the debt corresponding to the invoices submitted for payment as from the date of entry into force of the state of alarm.
- **Guarantees**. The granting of guarantees is authorised within the framework of the European Temporary Support Instrument to mitigate unemployment risks in an emergency (SURE) and budgetary support is provided for the execution of guarantees granted by the Ministry of Economic Affairs and Digital Transformation on the basis of the RD on extraordinary urgent measures to deal with the economic and social impact of COVID-19.
- **Sectoral framework agreements on loan deferrals**. Conventional deferrals between the debtor and his financial institution under a Sector Framework Agreement may cover all types of loans, credits and financial leases. In addition, the RD notes that individuals who are in a situation of financial vulnerability due to COVID-19 and can apply for the payment deferrals are both consumers and self-employed workers. These provisions shall only apply to financial institutions adhering to Sector Framework Agreements for conventional moratoria with their debtors as a result of the health crisis resulting from the COVID-19. These provisions set out that:
    - Institutions that adhere to a Sector Framework Agreement shall send information set out in this law which related to the granting of conventional payment deferrals to the Bank of Spain (BoS) every working day. Regarding the reporting requirements established for legal payment deferrals, this RD incorporates two additional requirements for conventional deferrals, they are the number of suspensions denied and the number of loans in which the debtor requests that the suspension be documented in a notarial deed.
    - Financial leasing contracts are added within the scope of application of this RD for the non-mortgage moratorium.
    - It may be agreed, without affecting the accrual of interest agreed in the initial loan contract, that the amount of the deferral shall be paid by:
        - The **redistribution of the installments** without changing the maturity date.
        - The **extension of the maturity date** by a number of months equivalent to the duration of the moratorium.

2. Main points (cont.)

- The debtor and the creditor may agree to extend, under the same conditions and premium initially agreed for the payment protection or loan protection insurances that had been taken out, the loan that is novated for the same period of time in which the maturity of the loan is extended, consequently debit of the premium.
- Payment deferrals cannot include or modify the contractual terms of initial loan (except the duration of the contract), it implies not to change the agreed interest rate, charge expenses or fees with certain exceptions such as interest-free loans or premiums for renewals of insurance contracts, commercialize another unit-linked product or provide additional guarantees not included in the original contract.
- When the financial entity grants a legal payment deferral and a conventional payment deferral, the second agreement signed with the debtor will expressly include recognition of the legal moratorium, suspending the effects of the conventional payment deferral until the time when the it ends.
- Prior to the establishment of the payment deferral agreement, the creditor must provide the obligor with simplified information on the conditions of the loan, together with the proposal for an agreement to establish the conventional moratorium, which must at least include the legal and economic consequences of the deferral and the conditions for extending the payment protection or loan repayment insurance that was initially taken out with the loan.
- When the moratorium only provides a deferment of the principal or principal and interest of a secured loan or credit or a financial lease whose registration requires the filing of a public document, the financial institution shall unilaterally raise the moratorium agreement signed by the debtor to public status provided that the deferral is implemented by extending the deadline and that the obligor has informed expressly that he did not go to the notary's office.

- **Submission of the Corporate Income Tax**. Corporate income taxpayers whose deadline for the preparation and approval of the annual accounts for the year meets the requirements, may file a corporate income tax return for the relevant tax period within 25 calendar days of the 6 months following the end of the tax period. If, at the end of the latter period, the annual accounts have not been approved by the corresponding governing body, the tax return will be made using the available annual accounts.

3. Next steps

- This royal decree-law came into force on **28 May 2020**.

14/04/2020

- **Final Rule: Six months delay of the effective date for the revised control framework**
- **Establishment of a temporary FIMA Repo Facility to help support the smooth functioning of financial markets**

1. Context

The Fed has published a **Final Rule delaying the effective date of the framework revision for determining whether a company controls another company for purposes of the Bank Holding Company Act (BHCA) or the Home Owners' Loan Act (HOLA)** with the aim of reducing the operational burdens and allow institutions to focus on current economic conditions. Furthermore, the Fed has announced the establishment of a **temporary repurchase agreement (Repo) facility for Foreign and International Monetary Authorities (FIMA)** to help support the smooth functioning of financial markets including the US Treasury market, and thus maintain the supply of credit to US households and businesses.

2. Main points

<u>Final Rule: Six months delay of the effective date for the revised control framework</u>

- **New effective date**. The Fed is delaying the effective date of the Final Rule for determining whether a company controls another company for purposes of the BHCA or the HOLA by two quarters, which should provide companies affected by the new control rule additional time to analyze the impact of the rule on existing investments and relationships. As a consequence of this change, the effective date for the final rule is delayed until September 30, 2020.

<u>Establishment of a temporary FIMA Repo Facility to help support the smooth functioning of financial markets</u>

- **Elegibility to participate**. The institutions eligible to apply to use the facility are most FIMA account holders, which consist of central banks and other foreign monetary authorities with accounts at the Federal Reserve Bank of New York (FRBNY). Applications for usage of the facility must be approved by the Fed.
- **Functioning of the FIMA Repo Facility**. The FIMA repo facility would allow foreign central banks to temporarily raise dollars by selling US Treasuries to the Fed's System Open Market Account and agreeing to buy them back at the maturity of the repurchase agreement. The term of the agreement will be overnight, but can be rolled over as needed. The transaction would be conducted at an interest rate of 25 basis points over the rate on Interest on Excess Reserves (IOER), which generally exceeds private repo rates when the Treasury market is functioning well, so the facility would primarily be used only in unusual circumstances such as those prevailing at present.

3. Next steps

- The effective date for the Final Rule is delayed until **September 30, 2020**.
- The FIMA Repo Facility will be available **beginning April 6** and will continue for at least **6 months**.

20/04/2020

- **Regulatory reporting relief to small financial institutions affected by the coronavirus (Fed)**
- **Notice on Standardized Approach for Calculating the Exposure Amount of Derivative Contracts (Fed, OCC, FDIC, Treasury)**
- **Regulatory Capital Rule: Revised Transition of the Current Expected Credit Losses Methodology for Allowances (Fed, OCC, FDIC, Treasury)**
- **Regulatory Capital Rule: Temporary Changes to the Community Bank Leverage Ratio Framework (Fed, OCC, FDIC, Treasury)**
- **Regulatory Capital Rule: Transition for the Community Bank Leverage Ratio Framework (Fed, OCC, FDIC, Treasury)**
- **Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Fed, OCC, FDIC, CFPB, NCUA)**
- **Interagency Statement on Appraisals and Evaluations for Real Estate Related Financial Transactions Affected by the Coronavirus (Fed, OCC, FDIC, CFPB, NCUA)**
- **Interim Final Rule on Real Estate Appraisals (Fed, OCC, FDIC, Treasury)**

1. Context

Since the beginning of March 2020, various agencies at both the local and supranational levels have begun to issue measures to mitigate the possible impact that the COVID-19 could have on the economy. In the US, the federal agencies are coordinating a joint effort to publish a series of measures and recommendations, specially the Fed, FDIC, OCC and Treasury.

In this context, the Fed has published a **Regulatory reporting relief to small financial institutions affected by the coronavirus** with the aim of offering additional time to submit certain regulatory reports in light of staffing priorities and disruptions caused by the COVID-19. Furthermore, the Fed, OCC, FDIC and Treasury (the agencies) have issued a **Notice on Standardized Approach for Calculating the Exposure Amount of Derivative Contracts**, the **Interim Final Regulatory Capital Rule: Revised transition of the current expected credit losses methodology for allowances**; **Temporary Changes to the Community Bank Leverage Ratio Framework**; **Transition for the Community Bank Leverage Ratio Framework** and the **Interim Final Rule on Real Estate Appraisals** with the aim to support the U.S. economy and allow banking organizations to continue lending to households and businesses. Additionally, the Fed, OCC, FDIC, CFPB and the NCUA have published the **Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus** and the **Interagency Statement on Appraisals and Evaluations for Real Estate Related Financial Transactions Affected by the Coronavirus**.

2. Main points

Regulatory reporting relief to small financial institutions affected by the coronavirus

- **Consolidated financial statements**. The Fed will not take action against a financial institution with $5 billion or less in total assets for submitting its March 31, 2020, Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) or Financial Statements of U.S. Nonbank Subsidiaries of U.S. Bank Holding Companies (FR Y-11) after the official filing deadline, as long as the applicable report is submitted within 30 days of the official filing due date.

Notice on Standardized Approach for Calculating the Exposure Amount of Derivative Contracts

- **Implementation of SAA-CCR**. The agencies are allowing banking organizations to implement the SA-CCR rule, including the SA-CCR methodology and the other amendments, on a best efforts basis immediately. A banking organization that elects to adopt the SA-CCR methodology must adopt the SA-CCR methodology for all derivative contracts; it cannot implement the SA-CCR methodology for a subset of its derivative contracts. However, a banking organization may adopt some of the other amendments described in the SA-CCR rule regardless of whether it chooses to early adopt the SA-CCR methodology.

2. Main points (cont.)

Revised Transition of the Current Expected Credit Losses Methodology for Allowances

- **Current expected credit loss (CECL)**. The interim final rule provides banking organizations that adopt CECL during the 2020 calendar year with the option to delay for two years the estimated impact of CECL on regulatory capital, followed by a three-year transition period to phase out the aggregate amount of the capital benefit provided during the initial two-year delay (i.e., a five-year transition, in total). Banking organizations that have already adopted CECL have the option to elect the three-year transition option contained in the 2019 CECL rule or the five-year transition contained in the interim final rule, beginning with the March 31, 2020, Call Report or FR Y-9C.
- **Approximating the impact of CECL**. The interim final rule provides a uniform approach for estimating the effect of CECL during the five-year transition period. Specifically, the interim final rule introduces a scaling factor that approximates the average after-tax provision for credit losses attributable to CECL, relative to the incurred loss methodology, in a given reporting quarter. The interim final rule uses a 25 percent scaling factor as an approximation of the impact of differences in credit loss allowances reflected under CECL versus the incurred loss methodology.

Changes to the community bank leverage ratio

- **Leverage ratio**. The interim final rules will modify the community bank leverage ratio framework so that:
    - Beginning in the second quarter 2020 and until the end of the year, a banking organization that has a leverage ratio of 8 percent or greater and meets certain other criteria may elect to use the community bank leverage ratio framework.
    - Community banking organizations will have until January 1, 2022, before the community bank leverage ratio requirement is re-established at greater than 9 percent.
- **Gradual transition**. Under the interim final rules, the community bank leverage ratio will be 8 percent beginning in the second quarter and for the remainder of calendar year 2020, 8.5 percent for calendar year 2021, and 9 percent thereafter. The interim final rules also maintain a two-quarter grace period for a qualifying community banking organization whose leverage ratio falls no more than 1 percent below the applicable community bank leverage ratio.

Revised Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus

- **General Safety and Soundness**. The agencies encourage financial institutions to work with borrowers and will not criticize institutions for doing so in a safe and sound manner. The agencies view prudent loan modification programs offered to financial institution customers affected by COVID-19 as positive and proactive actions that can manage or mitigate adverse impacts on borrowers, and lead to improved loan performance and reduced credit risk.
- **Accounting and Reporting**. If a loan modification is not eligible under Coronavirus Aid, Relief, and Economic Security Act, or if the institution elects not to account for the loan modification under that Act, the financial institution should evaluate whether the modified loan is a troubled debt restructuring (TDR). Financial institutions may presume that borrowers are not experiencing financial difficulties at the time of the modification for purposes of determining TDR status if:
    - The modification is in response to the National Emergency.
    - The borrower was current on payments at the time the modification program is implemented.
    - The modification is short-term (e.g., six months).
- **Discount Window Eligibility**. The agencies remark that loans that have been restructured will generally continue to be eligible as collateral at the Federal Reserve Board's (FRB) discount window.
- **Consumer Protection**. The agencies encourage financial institutions to consider prudent arrangements that can ease cash flow pressures on affected borrowers, improve their capacity to service debt, increase the potential for financially stressed residential borrowers to keep their homes, and facilitate the financial institution's ability to collect on its loans.

2. Main points (cont.)

Appraisals and evaluations for real estate related financial transactions affected by the coronavirus

- **Real Estate appraisals**. The agencies are deferring certain appraisals and evaluations for up to 120 days after closing of residential or commercial real estate loan transactions. Transactions involving acquisition, development, and construction of real estate are excluded from this interim rule.
- **Exceptions on appraisal regulations**. The agencies encourage financial institutions to make use of the exceptions to the requirement for an appraisal by a certified or licensed appraiser. Exceptions that lenders may find the most useful during the COVID-19 emergency for real-estate related financial transactions include:
  - A residential real estate loan with a transaction value of $400,000 or less.
  - A commercial real estate loan transaction with a transaction value of $500,000 or less.
  - A business loan that has a transaction value of $1 million or less where the loan does not depend on the sale of, or rental income derived from, real estate as the primary source of repayment.

3. Next steps

- The Notice on standardized approach for calculating the exposure amount of derivative contracts will be effective **since its publication on the federal register**.
- Comments on the interim final rule on Revised transition of the current ECL methodology for allowances must be received no later than **45 days after its publication on the federal register**.
- Comments on the interim final rules on Changes to the community bank leverage ratio must be received no later than **45 days after its publication on the federal register**.
- The temporary provisions on Real Estate appraisals will **expire on December 31, 2020**, unless extended by the federal banking agencies.

25/05/2020

Regulatory Capital Rule: Temporary Exclusion of U.S. Treasury Securities and Deposits at Federal Reserve Banks from the Supplementary Leverage Ratio for Depository Institutions

1. Context

The spread of the coronavirus disease 2019 has significantly and adversely affected global financial markets, including depository institutions' role as financial intermediaries. In particular, the current health crisis have caused depository institutions' balance sheets to expand to accommodate inflows of deposits.

In this context, the Fed, FDIC and OCC (the Agencies) have published the **Regulatory Capital Rule on Temporary Exclusion of US Treasury Securities and Deposits at Federal Reserve Banks from the Supplementary Leverage Ratio (SLR) for Depository Institutions** with the aim of establishing temporary modifications that will provide flexibility to certain depository institutions to expand their balance sheets in order to provide credit to the real economy.

2. Main points

- **Scope**. Depository institutions subsidiary of a US global systemically important bank (G-SIB) holding company or any depository institution subject to Category II (includes those with at least $700 billion in total consolidated assets or at least $75 billion in cross-jurisdictional activity and at least $100 billion in total consolidated assets) or Category III (includes those with at least $250 billion in average total consolidated assets or at least $100 billion in average total consolidated assets and at least $75 billion in average total nonbank assets, average weighted short-term wholesale funding; or average off-balance sheet exposure) capital standards.
- **Total leverage exposure**. The agencies are issuing this interim final rule to provide depository institutions subject to the SLR the ability to exclude temporarily US Treasury securities and deposits at Fed Banks from the calculation of the SLR. The Tier 1 LR is not affected by this interim final rule.
- **Capital distributions**. A depository institution that opts into this treatment would be required to obtain approval from its primary Federal banking regulator before making a distribution or creating an obligation to make such a distribution so long as the temporary exclusion is in effect. The primary Federal banking regulator will consider all relevant factors, including whether any distribution would be contrary to safety and soundness and limitations on distributions in the existing rules applicable to the electing depository institution.

3. Next steps

- The interim final rule is **effective as of the date of Federal Register publication** and will remain in effect through **March 31, 2021**.
- Depository institutions must notify its primary Federal banking regulator of its election to adopt the temporary exclusion within **30 days** after the interim final rule is effective.

25/05/2020

- **Interagency Policy Statement on Allowances for Credit Losses**
- **Interagency Guidance on Credit Risk Review Systems**

1. Context

In 2016 the Financial Accounting Standards Board (FASB) issued the Accounting Standards Update (ASU) that set the loss methodology for credit losses. After the publication of these standards, the FASB published updates related to credit losses which would maintain conformance with the generally accepted accounting principles (GAAP) and FASB Accounting Standards Codification (ASC).

In this context, after the consultation launched in October 2019, the Agencies have issued the **Interagency Policy Statement (PS) on allowances for credit losses (ACLs)** with the aim of promoting consistency in the interpretation and application of the FASB credit losses accounting standard, which introduces the current expected credit losses (CECL) methodology. In particular, this policy statement describes the measurement of ECL, the design, documentation and validation for ECL estimation processes, including the internal controls over these processes, the maintenance of appropriate ACLs, the responsibilities of boards of directors and managements, and examiner reviews of ACLs.

In addition, the Agencies have also issued the **Interagency Guidance on credit risk review systems** in order to present principles for establishing a system of independent, ongoing credit risk review in accordance with safety and soundness standards.

2. Main points

<u>Interagency Policy Statement on Allowances for Credit Losses</u>

- **Scope**. The credit losses accounting standard applies to all banks, savings associations, credit unions, and financial institution holding companies regardless of size, that file regulatory reports for which the reporting requirements conform to GAAP.
    - The <u>CELC methodology applies</u> to financial assets measured at amortized cost, net investments in leases, and off-balance-sheet credit exposures (collectively, financial assets).
    - The <u>CELC methodology does not apply</u> to the following financial assets: financial assets measured at fair value through net income, available-for-sale debt securities, loans held-for-sale, policy loan receivables of an insurance entity, loans and receivables arising from operating leases.
- **Measurement of ACLs for loans, leases, held-to-maturity debt securities, and off-balance-sheet credit exposures**. An ACL is a valuation account that is deducted from, or added to, the amortized cost basis of financial assets to present the net amount expected to be collected over the contractual term of the assets. ACLs are evaluated as of the end of each reporting period. In particular, this PS covers, among others, the following aspects of the measurement of ACL's: collective evaluation of expected losses, estimation methods for ECLs, historical loss information or financial assets with zero credit loss expectations.
- **Measurement of the ACL for available-for-sale debt securities**. This PS establishes that credit losses for available-for-sale debt securities are evaluated as of each reporting date when the fair value is less than amortized cost. It requires credit losses to be calculated individually, rather than collectively, using a discounted cash flow method, through which management compares the present value of expected cash flows with the amortized cost basis of the security. An ACL is established, with a charge to the provisions for credit losses (PCL), to reflect the credit loss component of the decline in fair value below amortized cost. If the fair value of the security increases over time, any ACL that has not been written off may be reversed through a credit to the PCL. The ACL for an available-for-sale debt security is limited by the amount that the fair value is less than the amortized cost, which is referred to as the 'fair value floor'.

2. Main points (cont.)

- **Documentation standards**. This PS establishes that for financial and regulatory reporting purposes, ACLs and PCLs must be determined and should be well documented, with clear explanations of the supporting analyses and rationale. Further, sound policies, procedures, and control systems should be appropriately tailored to an institution's size and complexity (organizational structure, business environment and strategy, risk appetite, among others). In particular, an institution's policies and procedures for the systems, processes and controls necessary to maintain appropriate ACLs should address, among others, processes that support the determination and maintenance of appropriate levels for ACLs, and processes for determining and revising the appropriate techniques and periods to revert to historical credit loss information.
- **Analyzing and validating the overall measurement of ACLs**. This PS establishes that the management should document its measurements of the amounts of ACLs reported in regulatory reports and financial statements, if applicable, for each type of financial asset and for off-balance-sheet credit exposures. The board of directors, or a committee thereof, should review management's assessments of and justifications for the reported amounts of ACLs.
- **Examiner review of ACLs**. Examiners are expected to assess the appropriateness of management's loss estimation processes and the appropriateness of the institution's ACL balances as part of their supervisory activities.

<u>Interagency Guidance on Credit Risk Review Systems</u>

- **Elements of an effective credit risk review system**. This guidance establishes that an effective credit risk review system starts with a written credit risk review policy. In particular, these policies include a description of the overall risk rating framework and establish responsibilities for loan review based on the portfolio being assessed, and addresses the following elements:
    - <u>Qualifications of credit risk review personnel</u>. Personnel must be qualified in both sound lending practices and the institution's lending guidelines for the types of loans offered by the institution.
    - <u>Independence of credit risk review personnel</u>. An effective credit risk review must incorporates both the initial identification of emerging problem loans by loan officers and other line staff, and an assessment of loans by personnel independent of the credit approval process.
    - <u>Frequency</u>. Review and evaluation of an institution's significant loans, loan products, or groups of loans are typically made in an annual basis, on renewal, or more frequently when internal or external factors indicate a potential for deteriorating credit quality or the existence of one or more other risk factors.
    - <u>Scope</u>. A properly designed scope considers the current market conditions or other external factors that may affect a borrower's current or future ability to repay the loan.
    - <u>Depth of review</u>. Loans and portfolio segments selected for review are typically evaluated for Credit quality, soundness of underwriting and risk identification, borrower performance, and adequacy of the sources of repayment, among other things.
    - <u>Review of findings and follow-up</u>. An effective system includes processes for all noted deficiencies and weaknesses that remain unresolved beyond the scheduled time frames for correction to be promptly reported to senior management and the board of directors or appropriate board committee.
    - <u>Communication and distribution of results</u>. Effective communication also typically involves providing results of the credit risk reviews to the board of directors or appropriate board committee quarterly.

3. Next steps

- The interagency policy statement on allowances for credit losses **is effective** at the time of each **institution's adoption of FASB accounting standards on credit losses**.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

01/06/2020
Policy Statement 11/20 on credit risk: Probability of Default and Loss Given Default estimation

1. Context

In September 2019, the PRA published a Consultation Paper (CP) 21/19 on credit risk which updated the Supervisory Statement (SS) 11/13 on Internal Rating Based (IRB) by implementing a set of the European Banking Authority (EBA) regulatory products that relate to probability of default (PD) estimation and loss given default (LGD) estimation.

In this context, the PRA has published a **Policy Statement (PS) 11/20 on credit risk: PD and LGD estimation** which updates again the SS 11/13 on IRB with the feedback received to the CP 21/19. In particular, the main changes to the policy are: i) extending the implementation deadlines for the EBA roadmap and the mortgage hybrid approach; ii) amending the approach to discounting cured exposures; and iii) accepting temporary divergence between accounting impairment models and approved IRB models for defaulted exposures, due to the need to make timely changes to impairment models. Further, this document Policy Statement clarifies the use of Sterling Overnight Index Average (SONIA).

2. Main points

- **Implementation deadlines**. The PRA, taking in consideration the feedback provided and the implications of COVID-19, has decided to extend the implementation deadline for all changes to residential and non-residential mortgage exposures by one year and one day to 1 January 2022. In particular, this change in the deadlines applies to the following regulatory changes:
    - Definition of default and PD and LGD estimation, both for residential and non-residential mortgage exposures.
    - Mortgage hybrid approach, only for residential mortgage exposures.

  However, this new deadlines applies only to firms using the IRB approach, because for firms only using the SA approach the deadline for the materiality threshold is on the 31 December 2020, both for residential and non-residential mortgage exposures. Nonetheless, for the definition of default for these firms, the deadline is the same as before, which is 1 January 2022.
- **Recognition of local regulatory approaches for calculating group consolidated capital requirements**. With respect to the questions presented by the stakeholders regarding that whether for IRB models used by non-UK subsidiaries of UK groups, the PRA would permit the non-UK solo capital requirements calculated using local IRB requirements to also be used in the UK group consolidated capital requirement calculation. Additionally, one respondent asked about the reverse case where a UK firm has a parent organisation in a different EEA jurisdiction. In this sense, the PRA has provided the following feedback:
    - The joint decision process of the CRR applies until the end of the transition period following the UK's withdrawal from the EU on Thursday 31 December 2020.
    - The PRA will clarify its approach on the treatment of overseas models post-Thursday 31 December 2020 at a later date.
    - The policy that permits UK firms to apply the definition of default materiality thresholds set by other prudential regulators in their group consolidated capital requirements on the basis that the thresholds should be tailored to local market characteristics, economic conditions and financial risk is still applicable.
- **Approach to discounting cured exposures**. In the CP 21/19, the PRA proposed that firms should only include accrued interest up to the moment of cure when calculating the artificial cash flow (defined in the Guidelines (GL) on PD & LGD), a process that is called discounting cured exposures. In response to the feedback received from the CP, the PRA has decided to make the following amendments to its first proposal:
    - Apply the proposed approach to calculating the value of interest payments to other components of the artificial cash flow. Therefore, the artificial cash flow should reflect: i) principal, ii) interest, iii) fees, iv) additional observed recoveries, v) additional drawings, and vi) costs.
    - Remove the "independence period" from the definition of the "minimum cure period", which will be now referred as the "probation period".
    - Align the "accrual period" (i.e. the period in which the components of the artificial cash flow are accrued) with the "discounting period" (i.e. the period over which the artificial cash flow is discounted).

2. Main points (cont.)

- **Treatment of defaulted exposures**. The PRA, in relation with the proposal to delete its existing expectations for the treatment of defaulted exposures and taking in consideration the feedback made to this decision, has decided that:
    - It is not necessary for firms to develop new, separate or original IRB models for defaulted exposures, provided that firms can demonstrate the model used either satisfies or can be adjusted to satisfy the requirements for own-LGD estimates in the CRR.
    - All new IRB models and changes to existing IRB models require PRA approval or notification. Where a firm is using an impairment model as their Best Estimate of Expected Loss (ELBE) or LGD in-default model, there may need to be temporary divergence between the impairment model and the approved IRB model due to the need to make timely changes to accounting impairment models.
    - Firms should submit appropriate documentation for all new IRB models and changes to existing IRB models in line with regulatory requirements, in order to demonstrate compliance with the CRR and relevant RTSs, GL and PRA SSs.
- **Availability of the approaches under Section 7 of the GL on downturn LGD estimation where observed or estimated impact is not available**. In this regard, the PRA has decided to maintain the proposed policy, clarifying that even if an approach under Section 7 of the GL on downturn LGD were applied, firms would still be required to produce a downturn LGD model that is fully compliant with the CRR and the relevant RTSs, GLs and PRA SSs.

3. Next steps

- The policy set out in this PS will take effect from **1 January 2022**.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

01/06/2020
Statement re guidance on the application of regulatory capital and IFRS 9 requirements to payment holidays granted or extended to address the challenges of Covid-19

1. Context

On March 2020, the Bank of England (BoE) and Prudential Regulation Authority (PRA) announced a number of supervisory and prudential policy measures aimed at addressing the challenges of Covid-19. Particularly, the PRA wrote to the CEOs of UK banks and building societies (firms) providing guidance on, among other things, the application of expected credit loss (ECL) and of the regulatory definition of default in the context of Covid-19. Much of the previous guidance dealt with the treatment of the payment holidays or deferrals and the first payment deferrals are now coming to an end, therefore, the FCA has published a draft form updated guidance on how lenders should treat borrowers at the end of the initial deferral period.

In this context, the PRA has published a **Statement re guidance on the application of regulatory capital and IFRS 9 requirements to payment holidays granted or extended to address the challenges of COVID-19** which sets out the PRA's high-level view on the implications of that draft updated guidance from FCA for the guidance issued on March 2020, and on accounting and the regulatory definition of default more generally.

2. Main points

- **Treatment of payment deferrals, extensions to payment deferrals and exit from payment deferrals**. According to PRA's view, the eligibility for, and use of, Covid-19 related payment deferrals or extensions to those deferrals granted in accordance with the FCA's proposed guidance would not automatically result in a loan: i) being regarded as having suffered a significant increase in credit risk (SICR) or being credit-impaired for ECL purposes, or ii) triggering a default under CRR.
- **Regulatory definition of default**. In order to assess the treatment of payment deferrals, this statement set out the definition of default distinguishing between:
    - Borrowers able to resume full payments: the PRA would not expect them to be regarded as being in default for CRR purposes provided payments are made under an agreed revised schedule.
    - Borrowers unable to resume full payments: the PRA does not consider the use of a COVID-19 related payment deferral granted in accordance with the FCA's proposed guidance as triggering the counting of days past due, as generating arrears under CRR nor considering unlikely to pay under CRR. In particular, for the purpose of assessing unlikeliness to pay, it is expected from firms to place significant weight on information they have as to the reason why a borrower is unable to resume full payments at the end of the payment deferral, and not to focus only on the type of further measures applied. Furthermore, in applying CRR, it is important for firms to consider the distinction between:
        - **Borrowers who do not resume full payments** due to direct COVID-19 related issues that can reasonably be expected to be **temporary**. In this case, firms should take a **proportionate approach** to the assessment of unlikeliness to pay for this cohort of borrowers that appropriately reflects their **expected longer term ability to pay**.
        - **Borrowers who do not resume full payments** due to financial difficulty that is likely to be more **long term**. Firms would then need to assess whether this results in a distressed restructuring that is likely to result in a **diminished financial obligation and therefore a default**.
- **Identifying whether a significant increase in credit risk or credit impairment has occurred for IFRS 9**. The implementation of IFRS 9's ECL requirements follows three basic principles:
    - ECL should be implemented well and on the basis of the most robust, reasonable and supportable assumptions in the current environment in order to enhance consistency and reduce the risk of firms recognising inappropriate levels of ECL.
    - Forward-looking assessments need to take a balanced view of both the potential impact of the virus and the unprecedented level of support provided by governments and central banks domestically and internationally to protect the economy.
    - The assumptions that have been used in implementing ECL prior to COVID-19 and related actions should not be applied mechanically to the current circumstances.

  As the PRA consider that eligibility for COVID-19 related payment deferrals or would not automatically result in a loan being regarded as having suffered a SICR or being credit-impaired for ECL purposes, it notes that it is necessary to consider other SICR and credit impairment indicators beyond the borrower is past-due. The main reason is that it is important to distinguish borrowers using payment deferrals to manage temporary difficulties in making near-term payments from other borrowers, because some of the borrowers using payment deferrals to manage temporary difficulties in making near-term payments might not have suffered a SICR or be credit-impaired.

3. Next steps

- More details will be provided when the **FCA has finalised its guidance** on mortgages and coronavirus, which deals with how lenders should treat borrowers at the end of the initial deferral period.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

02/06/2020
Supervisory Statement 1/20 on Solvency II: Prudent Person Principle

1. Context

On 2009, the Solvency II Directive was released, and it introduced the "prudent person principle" which requires insurers to invest their assets held for regulatory purposes so as to ensure the security, quality, liquidity and profitability of their portfolio as a whole, which includes the need to be adequately diversified. Furthermore, this principle sets objective standards for prudent investment in relation to portfolio diversification, the use of financial derivatives, exposure to non-regulated markets and risk concentration, asset-liability matching and the security, quality and profitability of the whole investment portfolio.

In this context, the PRA has published a **Supervisory Statement (SS) 1/20 on Solvency II: Prudent Person Principle (PPP)** which sets out the PRA's expectations on firms in accordance with the requirements under the PPP under the Solvency II Directive regarding: i) their development and maintenance of an investment strategy; ii) their management of risks arising from investments and their internal governance within the investment function; and iii) their investment in assets not admitted to trading on a regulated market (hereafter "non-traded assets") and intragroup loans and participations.

2. Main points

- **Investment strategy**. The PRA expects firms to develop and document an investment strategy which describes at least:
  - Setting the investment objectives and strategic asset allocation, considering the investment constraints.
  - Alignment of the investment strategy with the business model and, where appropriate, how the strategy takes into account the nature and duration of a firm's liabilities and obligations, and the best interests of policyholders.
  - Alignment of investment strategy with board risk appetite, risk tolerance limits and investment risk and return objectives.
  - A complete list of assets and how those assets have been invested in accordance with the PPP.

  In addition, firms should review their investment strategy on an annual basis, which should challenged, approved and controlled by the board or relevant sub-committee of the board.
- **Investment risk management**. In this SS it is established that firms may only invest in assets the risks of which they are able to identify, measure, monitor, manage, control, report and take into account in their assessment of own solvency needs in the own risk and solvency assessment (ORSA). Furthermore, this SS sets out rules for:
  - Investment Risk Management Policy. The risk management system, in accordance with Solvency II, sets out that firms must produce policies including for:
    - **Underwriting** and **reserving**.
    - **Asset-liability** management.
    - **Investment risk** management.
    - **Liquidity risk** management.
    - **Concentration risk** management.
    - **Operational risk** management.
    - **Reinsurance** and other insurance **risk mitigation techniques**.

    Furthermore, firms must develop an investment risk management policy that, where appropriate, in order to ensure effective risk management, includes internal quantitative investment limits for assets and exposures. To set the aforementioned limits, the PRA expects firms should take into account at least the nature and duration of the liabilities or the need for proper diversification of assets, among others.
  - Counterparty risk. Internal quantitative investment limits should be set in order to ensure a properly diversified and resilient portfolio of assets that avoids a material reliance on counterparties.
  - Risk concentration, risk accumulation and lack of diversification. The PRA expects firms that:
    - They ensure that **assets issued by the same issuer**, or by issuers belonging to the same group, shall **not expose the insurance firm to excessive risk concentration**.
    - They demonstrate how their **quantitative investment limits and forward-looking investment strategy** would **prevent solvency from being threatened** under a range of stress scenarios.
    - Their have an **investment risk management policy** that will articulate how the firm has identified and is managing any **potential correlation or contagion risks** between assets which would lead to excessive concentration of risk.
- **Outsourcing of investment activities**. The PRA expects that firms will undertake appropriate due diligence in relation to outsourced investment activities. A firm's risk function should have the ability to understand and manage the specific risks associated with outsourcing its investment function or parts of its investment function. Additionally firms should be confident that any external party has sufficient risk management expertise to comply with this SS.

2. Main points (cont.)

- **Exposures to non-traded assets**. The PRA expects that, prior to investing in a non-traded asset, when determining any internal investment limit, firms will also consider and assess matters including the following: the appropriateness and robustness of the valuation methodology under a suitable range of operating conditions or the materiality of any embedded optionality, among others. In addition, regarding the purpose of managing the risks arising from these investments, they also expect that the level of expertise of key persons (including investment managers) and the robustness of risk management systems and controls would increase commensurate with any increases in the scale, complexity or concentration of investments in non-traded assets.
- **Valuation uncertainty**. The PRA expects that firms will have effective systems and controls in place to limit and manage their exposure to valuation uncertainty. This should include a framework for quantifying or grading their exposure to this risk, to enable them to define appropriate internal investment limits in respect of their investment in assets that expose them to valuation uncertainty. The appropriateness of that framework will depend on all the circumstances in each case, taking into account the principle of proportionality. In addition, the PRA expects that the level of valuation uncertainty and associated risks should be consistent with the defined risk appetite and investment strategy of the firm, including in stress scenarios.
- **Intragroup loans and participations**. In respect of assets backing technical provisions (TP), the PPP requires that these must be invested "in a manner appropriate to the nature and duration of the firm's insurance and reinsurance liabilities and in the best interests of all policyholders, taking into account any disclosed policy objectives". In this regard, the PRA expects that:
    - According to the requirement for assets backing TP to be invested in policyholders' best interests, the PRA consider that it is a high hurdle for firms to demonstrate that intragroup loans and participations are in the best interests of policyholders and, as such, a high hurdle to demonstrate that they are appropriate for covering TP.
    - A firm's board should be satisfied that any conflicts of interest have been resolved in the best interest of policyholders before investing in an intragroup asset. Any conflicts of interest that arise following investment in an intragroup transaction should also be resolved in the best interest of policyholders, which may mean ceasing to invest in that asset.
    - Intragroup assets are subject to at least the same level of "arm's length" scrutiny and risk management as other assets, as well as proper governance and documentation with regard to: conflict of interest, concentration risk, credit risk or the increase of the fragility of the group in stress scenarios due to the complexity of the group structure and its dependencies, among others.
- **Outwards reinsurance**. The PPP applies to all assets, including reinsurance arrangements. As for any asset, the PRA will take a case-by-case approach to considering whether reinsurance arrangements meet the PPP's standards, and will take into account a particular firm's circumstances, including the impact of various risk mitigation factors such as the use of collateral.

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25/05/2020

- **Statement on resolution measures and Covid-19 (PRA, BoE)**
- **Statement on prioritisation in light of Covid-19 (PRA)**
- **Statement on conversion of Pillar 2A capital requirements from RWA percentage to nominal amount (PRA)**

1. Context

The disruption of COVID-19 has caused the adoption of measures for local and supranational authorities to mitigate the economic impact from this pandemic. In particular, the Bank of England (BoE) and the Prudential Regulation Authority (PRA) have issued several measures to maintain financial stability, ensure the safety and soundness of firms and make sure policyholders are protected.

In this context, the PRA and the BoE have published a **Statement on resolution measures and COVID-19** aimed at alleviating operational burdens on PRA-regulated firms in response to the COVID-19 outbreak. In addition, the PRA has published the **Statement on prioritisation in light of COVID-19** which sets out further details of the PRA's plans to help firms maintain their safety and soundness and enable them to focus their resources on the supporting the UK economy to respond to the significant impact of Covid-19. Finally, the PRA has also issued the **Statement on conversion of Pillar 2A capital requirements from Risk Weighted Asset (RWA) percentage to nominal amount**, its objective is to alleviate unwarranted pressure on firms by setting all Pillar 2A requirements as a nominal amount, instead of a percentage of total Risk Weighted Assets (RWAs).

2. Main points

Statement on resolution measures and COVID-19

- **Resolvability Assessment Framework (RAF)**. In order to alleviate operational burdens on firms and ensure firms' senior management are able to engage fully in the RAF report submission and disclosure process, the dates or the major UK banks and building societies to submit their first reports on their preparations for resolution and publicly disclose a summary of these reports have been extended by a year, so they will be required to submit these reports by October 2021 and make public disclosures by June 2022. Furthermore, the BoE will make its first public statement on these firms' resolvability by June 2022.
- **Valuation in Resolution**. To provide flexibility to firms' core operational teams, the compliance deadline for the BoE's Statement of Policy on valuation capabilities to support resolvability has been extended by three months to 1 April 2021. The deadline for firms to implement the BoE's other Statements of Policy relevant to resolvability remains 1 January 2022.
- **Resolution plan reporting**. For reducing the immediate operational burden of resolution plan reporting, firms will not be required to submit certain resolution pack information under PRA Supervisory Statement SS19/13 'Resolution Planning' until the end of 2022, unless notified otherwise on an individual basis by the PRA.
- **Minimum Requirement for Own Funds and Eligible Liabilities (MREL)**. The BoE will continue to keep MRELs under review and monitor market developments carefully in Q3 of this year to inform its approach in Q4 2020 to setting January 2021 MRELs and indicative January 2022 MRELs. Furthermore, the BoE has clarified that it intends to exercise its discretion with respect to the transition time firms are given to meet higher MRELs. Firms not currently subject to a leverage-based capital requirement, but which subsequently become subject to one, will be given at least 36 months after that requirement takes effect to meet the higher MREL resulting from it.

Statement on prioritisation in light of COVID-19

- **Climate change**. Recognizing current pressures on firms, and in light of the responses to the December 2019 Discussion Paper on the Climate Biennial Exploratory Scenario, the Prudential Regulation Committee (PRC) and the Financial Policy Committee (FPC) have agreed to postpone the launch of the exercise until at least mid-2021. Even though COVID-19 represents a present risk, minimising the future risks from climate change requires action now, so the BoE will continue its work to better understand and mitigate these risks, including:
    - Continued support for firms' enhancements of their climate risk capabilities. In order to help with this, this summer the PRA will issue follow-on guidance on the PRA's 2019 Supervisory Statement on enhancing firms' approaches to managing the financial risks from climate change.
    - Continuation of the BoE's international engagement on climate issues. This includes working with other central banks within the Network for Greening the Financial System, through which guides on key issues like supervision and scenario analysis will shortly be published.
    - Continued focus on embedding climate disclosure across the financial system, including through the BoE's own disclosures.

2. Main points (cont.)

- **LIBOR transition**. Due to COVID-19, the PRA and the Financial Conduct Authority (FCA) suspended transition data reporting at the end of Q1, and cancelled some Q1 firm meetings. In light of the developments since, the PRA and FCA have decided to resume full supervisory engagement on LIBOR from 1 June 2020, including data reporting at the end of Q2.
- **Insurance Stress Test 2019**. The PRA has decided to pause further work on the Insurance Stress Test, given other pressures on firms and the need to focus on COVID-19 specific stresses. Therefore the PRA will not publish the results of last year's test and will postpone the next Insurance Stress Test to 2022, with a view to seeking feedback from firms on the proposed design during Q4 2021.
- **Stressed Value at Risk (SVAR)**. In the PRA's Supervisory Statement on Market Risk some expectations were set on how the 12-month period used for SVAR should be calculated, and how frequently it should be reassessed. With respect to the last point, the PRA do not expect that firms update their SVAR 12-month period during the current period of financial market stress, other than if a firm's current period no longer represents a significant period of stress for the firm's portfolio. In line with EBA guidance, is allowed for firms to delay until December 2020 the review of the choice of historical data.

<u>Statement on conversion of Pillar 2A capital requirements from RWA percentage to nominal amount</u>

- **Conversion of Pillar 2A requirements**. The Bank's approach is that they do not believe that RWAs are a good approximation for the evolution of the risks captured in Pillar 2A in a stress. The PRA will continue to regularly assess the appropriate level of Pillar 2A; given these regular assessments we believe the most proportionate approach is to set Pillar 2A as a nominal amount between assessments. As well as avoiding an absolute increase in Pillar 2A capital requirements in the current stress, this would reduce Pillar 2A, as well as the threshold at which firms are subject to maximum distributable amount (MDA) restrictions.
- **Implementation**. The PRA will set Pillar 2A as a nominal amount in the 2020 and 2021 Supervisory Review and Evaluation Processes (SREPs). The PRA invites all firms who do not have a SREP assessment due in 2020 to apply for a conversion of their current Pillar 2A requirement into a nominal amount using RWAs as of end-December 2019. This change is voluntary, subject to supervisory agreement, and would apply until the firm's next regularly-scheduled SREP.

BANK OF ENGLAND

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

25/05/2020
Statement on credit risk mitigation eligibility and leverage ratio treatment of loans under the Bounce Back Loan Scheme (BBLS)

1. Context

The COVID-19 Bounce Back Loan scheme (BBLS) has recently been launched to mitigate the economic impact of the COVID-19 outbreak, specially to enable businesses to access finance more quickly during the pandemic.

In this context, the PRA has published a **Statement on credit risk mitigation eligibility and leverage ratio treatment of loans under the Bounce Back Loan Scheme (BBLS)** with the aim of setting out the PRA's observations on the risk-weighted treatment of exposures under the UK Government's Bounce Back Loan Scheme (BBLS) and particularly eligibility for recognition as unfunded credit risk mitigation (CRM) under the Capital Requirements Regulation (CRR) as well as a related change to the UK leverage ratio framework.

2. Main points

- **Credit Risk Mitigation eligibility of guarantees in the scheme**. Firms are encouraged to review relevant articles of the CRR, and any relevant PRA rules and guidance to confirm that all the applicable requirements and expectations have been satisfied. The PRA considers that the terms of the guarantee provided by the BBLS do not contain features that would render these guarantees ineligible for recognition as unfunded credit risk protection, and the effects of these guarantees would appear to justify such treatment. It implies that if the guarantee meets the conditions in CRR, it may allow a firm to adjust risk weights and expected loss amounts.
- **Leverage ratio treatment of loans under the scheme**. The PRA is offering a modification by consent for banks subject to the UK Leverage Ratio Part of the PRA Rulebook to exclude the government guarantees in full loans from banks to small and medium-sized businesses under BBLS from the leverage ratio total exposure measure, if they choose to do so. It also allows firms to exclude loans made pursuant to schemes of a similar character which are 100% guaranteed by a government or central bank of an EEA state or the ECB provided that such loans do not exceed €60,000 per loan.

27/04/2020

- **Temporary Guidance for firms: Personal loans and coronavirus**
- **Temporary Guidance for firms: Overdrafts and coronavirus**
- **Temporary Guidance for firms: Credit cards (including retail revolving credit) and coronavirus**

1. Context

Since the beginning of March 2020, various agencies at both the supranational and local levels have issued measures to mitigate the possible impact that the COVID-19 could have on the economy. In the UK, the Bank of England (BoE) issued a set of measures to respond to the economic shock from COVID-19 with the aim to help UK businesses and household bridge across the economic disruption that is likely to be associated with this virus. Furthermore, the BoE and the Prudential Regulation Authority (PRA) have published a set of supervisory and prudential policy measures to address the challenges of COVID-19.

In this context, the FCA has published three **Temporary Guidances for firms** which cover **personal loans overdraft and credit cards (including retail revolving credit) and coronavirus**, with the aim of protecting consumers by providing them with temporary support in the light of the current exceptional circumstances arising out of coronavirus.

2. Main points

Temporary Guidance for firms: Personal loans and coronavirus

- **Scope**.
  - Regulated firms that issue personal loans. It only applies to credit union loans where they are regulated credit agreements.
  - Firms that have acquired personal loans.
  - Customers that are already experiencing or reasonably expect to experience temporary payment difficulties.
- **Payment deferrals**. It is an arrangement under which a firm permits the customer to make no payments under their regulated credit agreement for a specified period without being considered to be in arrears. Where a customer wishes to receive a payment deferral, a firm should grant the customer a payment deferral for 3 months. If this payment deferral is not considered appropriate, firms should offer other ways (e.g. reduced payments or rescheduled term) to provide temporary relief to the customer. Where a customer who received a payment deferral or a different solution for a period is entitled at the end of the period to forbearance, then as part of this, FCA expects any interest accrued during the relevant period to be waived.

Temporary Guidance for firms: Overdrafts and coronavirus

- **Scope**.
  - Firms with permission to accept deposits and which provides a current account with an overdraft facility.
  - Primary personal current accounts.
  - European Economic Area (EEA) firms who currently passport into the UK.
  - It does not apply to private banks and credit unions.
  - Customers that are already experiencing or reasonably expect to experience temporary payment difficulties as a result of coronavirus.
- **Interest free overdrafts**. Firms should, at the customer's request, assist the customer in the following way:
  - No interest should be payable in respect of up to £500 of the balance of the arranged overdraft.
  - Where an arranged overdraft has a limit of over £500, firms should not charge interest on the first £500 irrespective of whether the balance exceeds that amount.

  Where a firm instead chooses to extend an interest free amount to all customers with an arranged overdraft on their primary current account without the need for a request, this may be for a fixed period in the calendar that is the same for all customers. The interest free amount extended must be at least that required to be provided under this guidance with at least 3 months duration.

  The provision of new or increased arranged overdraft facilities is subject to the standard creditworthiness assessment by lenders.
- **Overdraft interest rate pricing**. Firms must review their prices to ensure they are set at a level that is consistent with the obligation to treat customers fairly in the light of the exceptional circumstances arising out of coronavirus. In this sense, firms have flexibility in the way they achieve this, it could include or be a combination of the following:
  - Not introducing any increase in price.
  - Reducing its published interest rates.
  - By manual adjustments.

  At the end of the 3 month period, providers should consider whether customers who have benefitted from these guidelines are in financial difficulty. If they are, then the lender should provide forbearance under normal policies and processes.

2. Main points (cont.)

Temporary Guidance for firms: Credit cards (including retail revolving credit) and coronavirus

- **Scope**.
  - Regulated firms who issue credit cards and retail revolving credit products.
  - Firms that have acquired credit cards and retail revolving credit products' debts.
  - It does not apply to business credit cards.
  - Customers that are already experiencing or reasonably expect to experience temporary payment difficulties as a result of coronavirus.
- **Payment deferrals**. It is an arrangement under which a firm permits the customer to make no payments under their credit card or revolving credit agreement for a specified period without being considered to be in arrears. Where a customer wishes to receive a payment deferral, a firm should grant the customer a payment deferral for 3 months unless the firm determines that it is obviously not in the customer's interests to do so (e.g. not able to repay any accrued interests). If a 3 month payment deferral is not considered appropriate, firms should without unreasonable delay, offer other ways (e.g. reduced payments) to provide temporary relief to the customer. Where a customer who received a payment deferral or a different solution for a period is entitled at the end of the period to forbearance, then as part of this, FCA expects any interest accrued during the relevant period to be waived. Persistent debt provisions and minimum repayment amount have been suspended for customers who have been granted a payment deferral.
- **Expectations in relation to credit card rates**. Firms should review prices set for credit cards to consider whether they are consistent with the obligation to treat customers fairly in the light of the exceptional circumstances arising out of coronavirus in order to ensure that they do not pose unjustifiable burdens on these customers who may be experiencing temporary payment difficulties.

3. Next steps

- The FCA Temporary guidance for firms came into force on the **14th April 2020**. Firms were free, however, to implement these measures sooner, at any time from 9 April. The FCA will review this guidance in the next 3 months in the light of developments regarding coronavirus and may revise the guidance if appropriate.
- Customers should be able to request the measures contained in these guidances at any point after they come into force for a period of **3 months**. This means that these measures (e.g. payment deferrals) could go beyond the point where the 3 month window for requesting them expires.

11/05/2020

- **Temporary Guidance for firms: High-cost short-term credit and coronavirus**
- **Temporary Guidance for firms: Rent-to-own, buy-now pay-later and pawnbroking agreements and coronavirus**
- **Temporary Guidance for firms: Motor finance agreements and coronavirus**

1. Context

Since the beginning of March, various agencies at both the local and supranational levels have issued measures to mitigate the possible impact that the COVID-19 could have on the economy. In the UK, the Bank of England (BoE) issued a set of measures to respond to the economic shock from COVID-19 with the aim to help UK businesses and household bridge across the economic disruption that is likely to be associated with this virus. Furthermore, the BoE and the Prudential Regulation Authority (PRA) have published a set of supervisory and prudential policy measures to address the challenges of COVID-19.

In this context, and after the publication of three previous temporary guidances, the FCA has published three new **Temporary Guidances for firms** which include COVID-19 measures for **high-cost short-term credit; rent-to-own, buy-now pay-later and pawnbroking agreements, and motor finance agreements**, with the aim of protecting consumers by providing them with temporary support in the light of the current exceptional circumstances arising out of coronavirus.

2. Main points

<u>Temporary Guidance for firms: High-cost short-term credit and coronavirus</u>

- **Scope**.
  - Regulated firms that enter into <u>high-cost short-term credit (HCSTC) loans</u> (including payday loans). It applies to both current loans and loans entered into after the guidance comes into force.
  - Firms that have acquired <u>HCSTC loans</u>.
  - Customers that are <u>already experiencing or reasonably expect to experience temporary payment difficulties</u>.
- **Payment deferrals**. It is an arrangement under which a firm permits the customer to make no payments under their regulated credit agreement for a specified period without being considered to be in arrears. Where a customer wishes to receive a payment deferral, a firm should grant the customer a payment deferral for at least one month. In order to treat customers fairly, no additional interest arising as a result of the deferral should be charged to the customer and the payment deferral should have no impact on the amount of the balance that was outstanding at the time when the payment deferral was granted. Finally, the firm should allow the customer to repay the deferred payment over such period and in such amount as the customer can reasonably afford, including over a period that extends beyond the original period of the loan.

<u>Temporary Guidance for firms: Rent-to-own, buy-now pay-later and pawnbroking agreements and coronavirus</u>

- **Scope**.
  - Regulated firms that enter into <u>rent-to-own</u> (RTO), <u>buy-now pay-later</u> (BNPL) or <u>pawnbroking agreements</u>. It does <u>not</u> apply to <u>peer to peer agreements</u>.
  - Firms that have acquired any of <u>these agreements</u>.
  - Customers that are <u>already experiencing or reasonably expect to experience temporary payment difficulties</u>.
- **Payment deferrals**. It is an arrangement under which a firm permits the customer to make no payments under their regulated credit agreement for a specified period without being considered to be in arrears. Where a customer wishes to receive a payment deferral, a firm should grant the customer a payment deferral for 3 months. If this payment deferral is not considered appropriate, firms should offer other ways (e.g. reduced payments or rescheduled term) to provide temporary relief to the customer. Where a customer who received a payment deferral or a different solution for a period is entitled at the end of the period to forbearance, then as part of this, FCA expects any interest accrued during the relevant period to be waived.
- **Pawnbroking agreements**. Where a customer is granted a payment deferral on a pawnbroking agreement, the firm should implement this by extending the redemption period for 3 months or, if the redemption period has already ended, agree not to give notice of intention to sell an item of pawn for that period.
- **BNPL agreements**. Where a customer is granted a payment deferral on a BNPL agreement and the customer is within the promotional period, the firm should implement this by extending the promotional period for 3 months. However, where the balance is not subject to a promotional period and is under a fixed-sum agreement, a payment deferral of 3 months should be provided under this guidance.
- **RTO agreements**. Where an RTO customer has a payment deferral or the agreement is extended it is expected that firms consider the impact on warranties or insurance sold or arranged by the firm. It is expected that firms take steps at least as favourable to those it has taken, or would take, where customers are in a similar position due to our standard forbearance rules.

2. Main points (cont.)

Temporary Guidance for firms: Motor finance agreements and coronavirus

- **Scope**.
  - Regulated firms that issue regulated motor finance agreements. This includes:
    - **Hire purchase** agreements (such as personal contract purchase (PCP) agreements).
    - **Conditional sale** agreements or other **debtor-creditor-supplier** agreements.
    - **Restricted-use debtor-creditor** agreements used to purchase a vehicle.
    - **Personal contract hire** (PCH) agreements.
  - Firms that have acquired any of these agreements.
  - Customers that are already experiencing or reasonably expect to experience temporary payment difficulties.
- **Payment deferrals**. It is an arrangement under which a firm permits the customer to make no payments under their regulated credit agreement for a specified period without being considered to be in arrears. Where a customer wishes to receive a payment deferral, a firm should grant the customer a payment deferral for 3 months. If this payment deferral is not considered appropriate, firms should offer other ways (e.g. reduced payments or rescheduled term) to provide temporary relief to the customer. Where a customer who received a payment deferral or a different solution for a period is entitled at the end of the period to forbearance, then as part of this, FCA expects any interest accrued during the relevant period to be waived.
- **PCP Guaranteed Minimum Future Value (GMFV), PCH Residual Value (RV) and other features of these agreements**. When granting a payment deferral or other option for assisting customers under PCP or PCH agreements affected by COVID-19, firms should not by any means seek to modify, or seek to unilaterally alter, any aspect of the original agreement in a way that takes advantage of the customer's necessity, lack of experience or weaker bargaining position or otherwise leads to unfair outcomes.
- **PCP agreements reaching term end during the period this guidance is in force**. Where a customer wishes to retain the vehicle, but does not have funds to cover the balloon payment due to coronavirus related financial difficulties, firms should work with the customer to find an appropriate solution. However, when a customer wishes to return the vehicle, but this is impractical due to the coronavirus situation, firms should inform the customer that they are unable to use the vehicle once the agreement has been terminated or come to an end, if that is the case.
- **Repossessions**. Where the customer has the right to use the vehicle, firms should not take steps to terminate the agreement or seek to repossess the vehicle where the customer is experiencing temporary payment difficulties as a result of circumstances relating to coronavirus and needs use of the vehicle.

3. Next steps

- The FCA Temporary guidance for firms came into force on the **27th April 2020**. FCA will review this guidance in the next 3 months in the light of developments regarding coronavirus and may revise the guidance if appropriate.
- Customers should be able to request the measures contained in these guidances at any point after they come into force for a period of **3 months**. This means that these measures (e.g. payment deferrals) could go beyond the point where the 3 month window for requesting them expires.

01/06/2020
Coronavirus and safeguarding customers' funds: proposed guidance for payment firms

1. Context

In April 2020, the FCA published the 2020/21 Business Plan where explained that payment services providers (PSPs) including payments institutions (PIs) and e-money institutions (EMIs) continue to develop quickly and more firms and new products are entering the market while more consumers and businesses are using PIs and EMIs. To this respect, the FCA is monitoring it closely for any harms to consumers or market integrity it may cause.

In this context, the FCA has published a **short consultation on proposed temporary guidance for payment firms** in order to strengthen payment firms' prudential risk management and arrangements for safeguarding customers' funds in light of the exceptional circumstances of the COVID-19. This proposed guidance should help firms prevent harm to their customers if firms fail, by making the wind-down process as orderly as possible and facilitating the return of customer funds in a timely manner.

2. Main points

- **Safeguarding requirements**. The requirement to safeguard applies to 'relevant funds' in both the Electronic Money Regulations 2011 (EMRs) and the Payment Services Regulations (PSRs). Under the EMRs, relevant funds are funds that have been received in exchange for e-money that has been issued. Under the PSRs, relevant funds are: (i) sums received from, or for the benefit of, a payment service user for the execution of a payment transaction, and (ii) sums received from a payment service provider for the execution of a payment transaction on behalf of a payment service user. In particular, safeguarding involves, among others, keeping records and accounts and making reconciliations, safeguarding accounts and acknowledgement letters, and disclosing information on treatment of funds on insolvency to customers.
- **Prudential risk management**. This proposed guidance establishes that prudential risk management includes areas such as:
  - Governance and control. Authorized Payment Institutions (APIs) and EMIs should ensure they have robust governance arrangements, effective procedures, and adequate internal control mechanisms, in accordance with their conditions of authorization.
  - Capital adequacy. Firms should accurately calculate their capital requirements and resources on an ongoing basis, and report these correctly in regulatory returns, as well as on request. To reduce exposures to intra-group risk, the best practice for firms is to deduct any assets representing intra-group receivables from their own funds. This is designed to ensure that there is an adequate level of financial resources within each individual regulated entity at all times to absorb losses. It also reflects the risk that a period of financial stress may affect the ability of other members of the firm's group to repay any amounts owed.
  - Liquidity and capital stress testing. Firms should carry out liquidity and capital stress testing to analyse their exposure to severe business disruptions and assess their potential impact, using internal and/or external data and scenario analysis.
  - Risk management arrangements. Firms are expected to consider their own liquid resources and available funding options to meet their liabilities as they fall due, and whether they need access to committed credit lines to manage their exposures.
- **Wind-down plans** are needed by firms to manage their liquidity and resolution risks. The wind-down plan should consider the winding-down of the firm's business under different scenarios. In particular, the wind-down plan should include/address the following aspects:
  - Funding to cover the solvent wind-down of the firm, including the return of all customer funds.
  - Realistic triggers to start a solvent wind-down and to seek advice on entering an insolvency process.
  - The need for any counterparties (i.e. merchants) to find alternative providers.
  - Information which would help an administrator or liquidator to quickly identify customer funds and return them as a priority.

3. Next steps

- Comments may be submitted until **5th of June 2020**.

01/06/2020
Guidance for insurance and premium finance firms

1. Context

During the last months, the Bank of England (BoE) issued a set of measures to respond to the economic shock from COVID-19 with the aim to help UK businesses and household bridge across the economic disruption that is associated with the health crisis. In this sense, the BoE and the Prudential Regulation Authority (PRA) have published a set of supervisory and prudential policy measures to address the challenges of COVID-19. The FCA, for its part, has issued several Temporary Guidances for firms which cover personal loans; overdraft; credit cards; high-cost short-term credit; rent-to-own, buy-now pay-later and pawnbroking agreements, and motor finance agreements.

In this context, the FCA has published a **Guidance for insurance and premium finance firms** with the aim of prompting firms to help qualifying customers to reduce the impact of temporary financial distress and ensure that customers continue to have insurance that meets their demands and needs. This guidance is intended for customers that are already experiencing or reasonably expect to experience temporary payment difficulties as a result of circumstances relating to coronavirus.

2. Main points

- **Scope**. This guidance applies to regulated firms operating in the insurance and premium finance markets. This includes insurers, insurance intermediaries, certain premium finance lenders and brokers, debt collectors and other firms that may be involved in insurance arrangements and/or in relation to the provision of premium finance. The guidance applies to all non-investment insurance contracts (i.e. general insurance and protection contracts) but not to re-insurance products.
- **Actions firms can take**. A firm should consider what options it can give to the customers in temporary financial difficulties that will serve as relief in light of their changed circumstances. The following actions may be the steps the firm considers will Help the customer understand their options:
    - Re-assessing the risk profile of the customer.
    - Considering whether there are other products the firm can offer which would better meet the customer's needs and revising the cover accordingly.
    - Working with customers to avoid the need for cancellation of necessary cover such as by considering payment deferrals.
    - Waiving cancellation fees and any fees associated with adjusting a qualifying customer's policy.

  Firms should consider if it is appropriate to take these steps for all products that the customer holds with the firm. These actions could result in a reduction in the monthly premium for customers paying by instalments and for customers who have paid up front, this could result in a partial refund of the premium.
- **Payment deferrals**. If amendments to the insurance cover do not help alleviate the temporary payment difficulties for customers paying their premium in instalments, firms are expected to grant customers a payment deferral unless it is not in the customer's interests to do so. In determining whether a payment deferral is not in customers' interests, firms should consider both customers' need for immediate temporary support and the longer-term effects of a payment deferral on the customers' situation. The payment deferral period should be for a period of between 1 and 3 months, though firms can go beyond 3 months should they wish to do so, and it is in the customer's interests. Where firms do not consider a payment deferral is appropriate, they should, without unreasonable delay, offer other ways to provide temporary relief to the customer.
- **Rates of interest**. Firms should consider reviewing any interest rates associated with instalments to ascertain whether they are consistent with the obligation to treat customers fairly.

3. Next steps

- After this guidance came into effect on 18 May 2020, **it will be reviewed within 3 months** of it coming into effect in light of developments around coronavirus to assess whether it is still needed.
- Customers be able to request a payment deferral at any point during the period up to **18 August 2020** while the window for requesting a payment deferral is open.

09/06/2020

- **Mortgages and coronavirus: updated guidance for firms**
- **Product value and coronavirus: guidance for insurance firms**

1. Context

During the last months, the Bank of England (BoE) issued a set of measures to respond to the economic shock from COVID-19 with the aim to help UK businesses and household bridge across the economic disruption that is associated with the health crisis. In this sense, the BoE and the Prudential Regulation Authority (PRA) have published a set of supervisory and prudential policy measures to address the challenges of COVID-19. The FCA, for its part, has issued several temporary guidances for firms which cover personal loans; overdraft; credit cards; high-cost short-term credit; rent-to-own, buy-now pay-later and pawnbroking agreements, and motor finance agreements. Furthermore, the FCA has also issued a temporary guidance for insurance and premium finance firms.

In this context, the FCA has published a **Guidance for firms on mortgages and coronavirus** which addresses the problems arising for customers that have to resume payments at the end of a payment deferral period. Furthermore, the FCA has also published a **Guidance for insurance firms on product value and coronavirus** which sets out FCA expectations for insurers and insurance intermediaries to consider the value of their products in light of the exceptional circumstances arising from COVID-19. Both guidance are temporary due to the situation caused by the coronavirus pandemic.

2. Main points

Mortgages and coronavirus: updated guidance for firms

- **Scope**. This guidance applies to the regulated mortgage contract or the regulated home purchase plan.
- **Customers who have not yet had a payment deferral**. Where a customer is experiencing or reasonably expects to experience payment difficulties as a result of circumstances relating to coronavirus, and wishes to receive a full payment deferral or partial payment deferral to reduce payments to an amount the customer believes they are currently able to afford, a firm should agree to this for 3 monthly payments. The firm can agree with the customer a different option that the firm reasonably considers to be in the best interests of the customer, this could be:
  - Offering a payment deferral of fewer than 3 months.
  - Offering a sustainable longer-term solution (e.g. extension of the term or an alternative product).
  - Offering more favourable forms of assistance (e.g. reducing or waiving interest).

  Where the customer and firm do not agree about the monthly payment a customer can afford, the firm should offer a payment deferral at the level sought by the customer and give customers adequate information to understand the implications of any support offered, to enable them to make an informed decision (e.g. personalised information on the impact on their monthly payments or the term of their mortgage).
- **Customers who have had a payment deferral**. Firms should take reasonable steps to contact their customers in good time before the end of a payment deferral period about resuming payments and to engage with them about their options when it expires. This contact should inform customers of what will happen if they do not respond, including the impact on their next monthly payment. This should include:
  - Information about default arrangements to capitalise the sums covered by a payment deferral.
  - Informing customers that other options are available to repay any sums covered by a payment deferral and how to access these or further support.

  Customers coming to the end of a payment deferral period should receive a fair treatment according to their financial circumstances. Firms should distinguish between those customers who:
  - Can resume full payments immediately. A firm should contact customers in good time before the end of the payment deferral period with information about the resumption of payments and on how to access further support if needed. If the customer has not responded, the firm may proceed on the basis the customer is able to resume full payments. Before capitalising any sums covered by a payment deferral the firm should give the customer personalised information on the impact on their monthly payments or the term of the mortgage. Where customers have been treated as able to resume full repayments but subsequently miss the next payment due under the mortgage, FCA expects firms to make further reasonable attempts to contact them. However, a firm may treat a customer who fails to respond to further communications after missing their first payment as being in payment shortfall in respect of the missed payment.
  - Are currently unable to resume full payments due to circumstances arising out of coronavirus. Where, after an initial payment deferral, and at any time before their first monthly payment is due, a customer indicates they cannot currently resume full payments, a firm should offer a full payment deferral, or a partial payment deferral to reduce their monthly payments to an amount the customer believes they are currently able to afford for 3 monthly payments. This is unless the firm agrees with the customer a different option according to the provisions of the payment deferrals as outlined in the prior bullet related to the customers who have not yet had a payment deferral. If a customer who has agreed a partial payment deferral or a payment deferral of less than 3 months contacts the firm seeking further assistance before the end of the payment deferral period, the firm should offer them additional support such as extending the payment deferral period to 3 months, reducing the agreed payment further or including to a full payment deferral.

2. Main points (cont.)

  - Payment shortfall. Unless otherwise specified, any sums covered by a payment deferral should not be considered to be a payment shortfall. However, where a firm varies the terms of a regulated mortgage contract or home purchase plan solely for the purposes of forbearance or to avoid a payment shortfall, Mortgage Conduct of Business (MCOB) continue to have effect.
- **Training, monitoring, record keeping and Credit Reference Agency reporting**. Firms should:
  - Ensure that staff are adequately trained to enable them to implement the firm's process for following this guidance.
  - Keep records of how any process was designed sufficient to demonstrate that the options presented were consistent with customers' best interests.
  - Record and monitor initial and further payment deferrals offered, any alternative measures provided, as well as any issues which might impede customers' ability to access the assistance required under this guidance.
  - According to the relevant Coronavirus Data Reporting Guidance published by the Credit Reference Agencies, firms should not report a worsening status on the customer's credit file during any initial or further payment deferral period.
  - Where customers have been unable to reach timely agreement with firms for a payment deferral because of firms' operational difficulties, FCA would expect firms to work with customers and Credit Reference Agencies to ensure that any necessary rectifications are made to credit files to ensure no worsening status is recorded regarding the payment deferral period.
  - Ensure no default or arrears charges are levied in relation to payments missed in these circumstances.
- **Repossessions**. Firms should not commence or continue repossession proceedings against customers before 31 October 2020. This applies irrespective of the stage that repossession proceedings have reached and to any step taken in pursuit of repossession. Where a possession order has already been obtained, firms should refrain from enforcing it. Additionally, firms should also ensure that their customers are kept fully informed, and discuss with them the potential consequences of their suspending any moves towards repossession.

Product value and coronavirus: guidance for insurance firms

- **Scope**. This guidance applies to all firms carrying on regulated activities relating to all non-investment insurance products and, in particular, firms who have manufactured these products. This will be relevant to all insurance products, whether the customer is retail or commercial. However, this guidance does not set out expectations for the review of re-insurance products.
- **Product reviews**. Firms should consider whether and how coronavirus may have materially affected the value of their insurance products. The effects of coronavirus may mean that:
  - Firms are no longer able to provide expected contractual benefits.
  - There has been a reduction in the chance of underlying insured events happening.

  Where firms identify something that could materially affect the value of the product they should consider the appropriate action to take. This could include delivering benefits in a different way, the provision of alternative, comparable benefits, reducing premiums for the duration of the change in value, or partial refunds of premiums already paid.
  Therefore, FCA expects that firms to be able to demonstrate to them how they have met their obligations at a product level and treated their customers fairly, which implies to communicate any issue that may adversely affect the customer and any actions firm is taking to address this.
- **Term**. Firms need to have completed this review of their product lines and decided on any resulting actions by no later than 6 months from the date of publication of this guidance. In addition, firms can also assess the longer term impacts of coronavirus on their insurance products on an ongoing basis beyond the 6-month period.

3. Next steps

- The guidance for firms on mortgages and insurance firms on product value are **already in force**:
  - The guidance for firms on mortgages will be in force until 31 October 2020.
  - Regarding the guidance for insurance firms on product value, the firms should complete their review of product lines and decided on resulting actions by no later than 3 December 2020.

19/06/2020
Finalised Guidance 20/1 Our framework: assessing adequate financial resources

1. Context

In March 2018, the FCA published their approach to supervision the firms with the aim of ensuring fair and honest markets, minimising harm to consumers or to the integrity of the UK financial system. To ensure that firms comply with the minimum financial resources requirements set out in the prudential standards in the FCA handbook and European prudential legislation, the FCA has established a supervision work which includes the assessment of adequate financial resources as well as setting up the threshold conditions to firms.

In this context, the FCA has published the **Finalised Guidance 20/1 Our framework: assessing adequate financial resources** with the aim of providing their approach to the assessment of adequate financial resources, for all FCA solo-regulated firms subject to threshold conditions and/or the Principles for Businesses (PRIN). In particular, this Guidance set outs the role of assessing adequate financial resources, expected practices to be adopted by firms when assessing adequate financial resources, and the expectations as to the practices firms should adopt in their assessment of adequate financial resources. It should be highlighted that this guidance does not place specific additional requirements on firms because of COVID-19, but the crisis underlines the need for all firms to have adequate resources in place.

2. Main points

- **Role of adequate financial resources in minimising harm**. The adequacy of financial resources is designed to: enable firms to remain financially viable and to provide services through the economic cycle, and to enable an orderly wind-down without causing undue economic harm to consumers or to the integrity of the UK financial system. Furthermore, the assessment of appropriate resources under threshold conditions should consider the nature and scale of a firm's business model, the risks to the continuity of the services provided and the impact of other members of the firm's group on the adequacy of its resources. To assess if a firm has adequate financial resources the FCA considers if a firm has the ability to meet its debts when they fall due.
- **Expected practices regarding adequate financial resources assessment**. Firm's assessment should be proportionate to the nature, scale and complexity of its activities.
  - All firms should <u>assess the risks inherent in their business model, the potential harm that can be caused and explain how to close the business in an orderly way</u>. The assessment should, among others, consider a forward-looking approach to risks and how these evolve throughout the economic cycle and ensure they are financially sound while avoiding excessive costs, which could hinder firms from carrying out their business in a viable way.
  - Firms should <u>understand</u> and articulate how <u>changes in operational and economic circumstances might affect the risks</u> to which they are exposed and their ability to generate acceptable returns.
  - Firms should understand the <u>risks in their activities so that they can detect, identify, and rectify problems themselves</u> by ensuring that their systems and controls, governance and culture enable them to take effective steps to prevent harm from occurring.
  - Firms should consider the <u>scenarios leading to financial stress</u>, explore recovery options and, as a last resort, wind down its business.
- **Expectations regarding the reduction of potential harm**.
  - <u>Financial resources</u>. Firms are required to hold an appropriate level of capital and/or liquid resources to cover potential harm. Capital includes elements of a firm's equity and appropriate loss-absorbing debt liabilities which rank behind general creditors, such as share capital and retained earnings, and subordinated debt. Firms should have adequate capital to:
    - Ensure they are **able to incur losses and remain solvent** or fail in an orderly way.
    - Drive the **right behavior**.
  - <u>Systems and controls, governance and culture</u>. An adequate risk management and controls framework needs to be supported by effective governance, leadership and a purpose. These elements should drive a culture that allows firms to identify, assess, manage, monitor and mitigate the risk of harm. Moreover, they should help firms to anticipate problems and take effective steps to prevent them from occurring or rectify problems when they occur.

2. Main points (cont.)

- Identify and assess the impact of harm. Identifying the potential harm, to consumers and markets, should help a firm to understand what can go wrong, so that it can implement controls to minimise the risk of this happening. Firms should consider 'what if' scenarios and estimate the potential impact. This is to determine the amount and type of financial resources needed to put things right when they go wrong. Harm can manifest itself as financial services markets working poorly and not providing enough benefit to users, losses suffered by consumers, or exclusion from financial markets and services.
- Risks that can lead to harm or impair the ability to compensate for harm done. The potential depletion of financial resources, or inability to monetise assets when needed, may impair a firm's ability to put things right when they go wrong. Firms should identify, understand, and assess all the material risks which can affect the level of financial resources they have available, not just those which cause direct harm to customers and markets. This is important to minimise the risk of a firm not being able to put things right when they go wrong.
- Viability and sustainability of the business model and strategy. Understanding a firm's business model and strategy helps identify emerging risk of harm, and if there is a misalignment between firms' profit incentive and the interests of consumers and financial markets. The risks of harm may be heightened if firms are under significant pressure for financial performance or on the verge of failure. Understanding a firm's financial vulnerabilities and proximity to failure is important to minimise its impact.
- Wind-down planning. Wind-down planning aims to reduce the impact of a firm's closure, related to potential harm from the inability to pay redress, inability to return or transfer client assets and money, or to interrupt continuity of service. This typically covers:
    - Scenarios leading a firm to **wind-down** its business.
    - Potential impact on **consumers and financial markets**.
    - **Operational tasks** required and time necessary to execute each task.
    - **Capital to absorb winding-down costs** and additional losses.
    - **Liquid resources** necessary to support cash outflows.

20/04/2020

- **Statement of Policy: Delaying annual company accounts during the coronavirus crisis (FCA)**
- **Guidance for companies on Corporate Governance and Reporting (COVID-19 pandemic) (FRC)**
- **Guidance on estimating expected credit loss (ECL) and the regulatory definition of default (PRA)**
- **Guidance for auditors and matters to consider where engagement are affected by COVID-19 (FRC)**
- **PRA decision on Systemic Risk Buffer rates (PRA)**

1. Context

Since the beginning of March 2020, various agencies at both the local and supranational levels have begun to issue measures to mitigate the possible impact that the COVID-19 could have on the economy. In the UK, the Bank of England (BoE) issued a set of measures to respond to the economic shock from COVID-19 with the aim to help UK businesses and household bridge across the economic disruption that is likely to be associated with this virus. Furthermore, the BoE and the PRA have published a set of supervisory and prudential Policy measures to address the challenges of COVID-19.

In this context, the FCA, the FRC and the PRA have published a **Joint statement to address COVID-19** with the objective of ensuring that information continues to flow to investors, helping companies preparing and auditors auditing financial statements in the current uncertain climate, and helping market participants and lenders to respond appropriately to audit report modifications and loan covenant breaches. Furthermore, the PRA published on April 9th a **Decision on Systemic Risk Buffer rates** in order to give lenders greater certainty over their capital requirements moving forward.

2. Main points

- **FCA – Changes in reporting timetable for listed companies**. The FCA has published a statement permitting a delay in the publication of audited annual financial reports from four to six months from the end of the financial year. This policy is intended to be temporary while the UK faces the extreme disruption of the coronavirus pandemic and its aftermath.
- **FRC – Guidance for companies on corporate governance and reporting**. The FRC encourages Boards on corporate governance to take the following measures, in order to maintain effective decision making in the interests of the company, their workforce and other business partners:
  - Develop and implement mitigating actions and processes to ensure that they continue to operate an effective control environment.
  - Consider how they will secure reliable and relevant information, on a continuing basis, in order to manage their future operations and those of their workforce and suppliers.
  - Pay attention to capital maintenance, ensuring that sufficient reserves are available when the dividend is made.

  Furthermore, the FRC has prepared a guidance for companies intended to help boards focus on areas of reporting of most interest to investors; and to encourage them to provide clarity on the use of key forward-looking judgements. The guidance covers:
  - The need for narrative reporting to provide forward-looking information that is specific to the entity and which provides insights into the board's assessment of business viability and the methods and assumptions underlying that assessment.
  - Going concern and any associated material uncertainties, the basis of any significant judgements and the matters to consider when confirming the preparation of the financial statements on a going concern basis.
  - The increased importance of providing information on significant judgements applied in the preparation of the financial statements, sources of estimation uncertainty and other assumptions made.
  - Judgement required in determining the appropriate reporting response to events after the reporting date and the extent to which qualitative or quantitative disclosures may be appropriate.
- **PRA – Guidance on estimating expected credit loss (ECL) and the regulatory definition of default**. The PRA has made some observations that need to be taken into account in the governance process around economic scenarios, probability weights, model adjustments and overlays:
  - Recognise that there are clear signs that economic and credit conditions are worsening, but taking into account the significant economic support measures that regulators have taken.
  - Reflect that the economic shock from the pandemic should be temporary, although its duration is uncertain.
  - Give due weight to established long-term economic trends when preparing long-term forecasts, given the challenges of preparing detailed forecasts far into the future.
  - Avoid double-counting between any adjustments for COVID-19 and existing adjustments for other uncertainties such as EU withdrawal.

2. Main points (cont.)

On the other hand, the PRA regarding the treatment of payment holidays and similar schemes reccomends:

- To not consider the use of a COVID-19 related payment holiday by a borrower to trigger the counting of days past due or generate arrears under CRR.
- To consider that the use of government-endorsed payment holidays by a borrower would not on its own trigger the counting of days past due for the 30 days past due backstop used to determine SICR or the 90 days past due backstop used to determine default.
- The payment holidays should not automatically trigger:
  - a default under CRR.
  - the loans involved being moved into Stage 2 or Stage 3 for the purposes of calculating ECL.
- Not to assume a SICR event unless there is evidence to the contrary. The PRA recommends to assess whether the overall impact on ECL could be material by considering the differential between 12 month and lifetime ECL for the volume of customers that have received a payment holiday but show no other indicators of SICR. If deemed material, an overarching allocation could be made based on a sample of accounts.

Furthermore, the PRA regarding the treatment of borrowers who breach covenants due to COVID-19 consider that firms have scope to assess covenant breaches on a case-by-case basis and determine whether they indicate unlikeliness to pay. Subject to that individual assessment, we would expect that when the reasons are of a general nature or are firm-specific but unrelated to the solvency or the liquidity of the borrower, the conclusion will generally be that neither a SICR nor default has occurred.

- **FRC – Guidance for auditors**. The FRC has issued guidance to auditors intended to provide practical help in obtaining sufficient, appropriate audit evidence. The guidance provide a non-exhaustive list of factors auditors should be considering when carrying out audit engagements in the current circumstances, along with guidance on how they might be addressed.
- **FCA/PRA/FRC – Additional further measures**. The agencies underline additional further measures to allow companies and auditors to focus on the delivery of information to investors and the capital markets, that include
  - Delaying the filing of accounts by companies.
  - Postponement of auditor tenders.
  - Postponement of audit partner rotation.
  - Reduction of FRC demands on companies and audit firms.
  - Extension of reporting deadlines for public sector bodies.
- **PRA – Preservation of the Systemic Risk Buffer (SRB)**. The PRA has decided to maintain firms' SRB rates at the rate set in December 2019 in response to the economic shock from Covid-19. This decision applies to the CRD IV SRB, and any successor systemic buffer which could be implemented following the adoption of CRDV.

3. Next steps

- The PRA will next reassess firms' SRB rates in **December 2021**.

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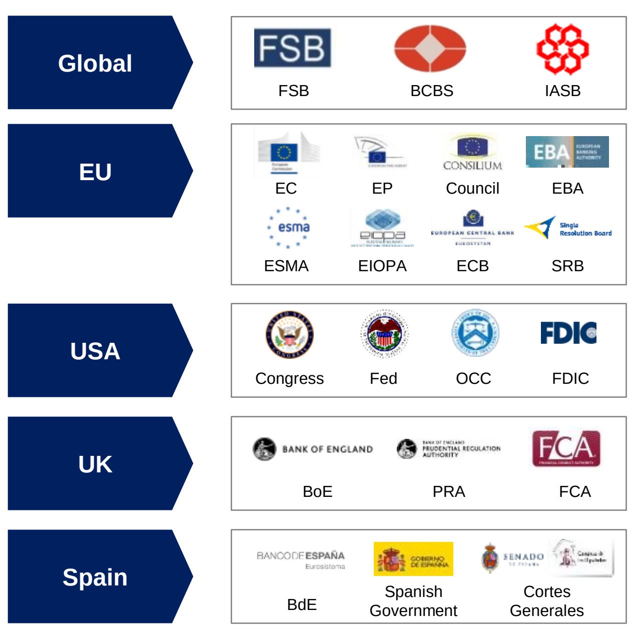

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