Financial Services Regulatory Insights

EU amends CRR to ease the impact of COVID-19

AT A GLANCE

July 2020

What's new?

- On 24 June 2020, the final rules that amend certain provisions of Capital Requirements Regulation (CRR) and CRR II in response to the coronavirus (COVID-19) pandemic were published in the Official Journal. The majority of the changes came into force on 27 June 2020. The amendments (known as the 'CRR quick fix') aim to alleviate the impact of COVID-19 on banks' capital requirements in order to support ongoing lending to consumers and businesses.
- The key changes are related to the deduction of certain software assets from capital, the leverage ratio and associated buffer, IFRS 9 transitional arrangements, suspension of distributions, preferential treatment of non-performing loans with public guarantees, and the treatment of exposures to central governments and non-EU countries.
- On 30 June 2020, the Prudential Regulation Authority (PRA) published a statement setting outs its position on the package.

What does this mean?

- The majority of the amendments implement the COVID-19-related measures agreed by the Basel Committee on 3 April 2020, but a number are EU-specific changes.
- *Leverage ratio*. When calculating the leverage ratio, banks will be allowed to exempt certain exposures to central banks from the total exposure measure until 27 June 2021. The leverage ratio buffer for G-SIBs, which was due to come into force on 28 June 2021, will now not be implemented until 1 January 2023.
- *IFRS 9 expected credit loss*. The CRR already included transitional provisions to reduce the impact on capital from the application of IFRS 9. These amendments have extended this transitional until end of 2024. This will allow banks to fully add back to their Common Equity Tier 1 capital any increase in new expected credit losses provisions that they recognise in 2020 and 2021 for their non-defaulted assets.
- Banks that had previously not chosen to take advantage of the transitional provision may do so at any point during the transitional period.
- *Software assets*. A key EU-specific amendment is to exempt certain software assets from deduction from capital. Under CRR II, firms are no longer required to deduct prudently-valued software assets from their Common Equity Tier 1 capital. Initially the revised treatment was set to apply 12 months after the entry into force of the relevant Regulatory Technical Standards (RTS) which the European Banking Authority (EBA) is currently consulting on. The application date is now the date of entry into force of the RTS.
- *Capital distributions*. EU National Competent Authorities are asked to make full use of their supervisory powers on the suspension of distributions of capital. In the UK, on 31 March 2020, the PRA asked deposit-takers to suspend dividends and buybacks on ordinary shares until the end of 2020, and to cancel payments of any outstanding 2019 dividends.

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- *Publicly guaranteed non-performing loans*. Another EU-specific, temporary change will align the minimum coverage requirements for non-performing loans benefiting from public guarantees with those guaranteed by official export credit agencies, as the two guarantees are deemed to have similar risk-mitigating effects. The measure will expire seven years after the date of entry into force of the CRR quick fix.
- *Sovereign exposures*. Firms with exposures to central governments can apply temporary prudential filters until the end of 2022, to mitigate the negative impact of the volatility in the sovereign debt markets on their regulatory capital and lending capacity.
- Moreover, firms investing in government bonds denominated in the currency of another Member State will benefit from preferential credit risk weighting treatment during a transition period ending in December 2024. Banks will also be allowed higher large exposure limits: 100% of Tier 1 capital until end-2023, 75% until end-2024, and 50% until end-2025.
- *Loans to employees and pensioners*. CRR II provides for lower risk weights assigned to loans granted to pensioners and employees with a permanent contract, backed by the borrower's pension or salary. The favourable treatment will be brought forward from 28 June 2021 to the date of entry into force of this regulation.
- *Exposures to infrastructure and SMEs*. The infrastructure supporting factor and the SME supporting factor under CRR II will also be brought forward to the date of entry into force of this regulation. This will allow firms to hold less capital against exposures to entities that operate or finance physical structures or facilities, systems and networks that provide or support essential public services, as well as to small and medium-sized enterprises.

What do firms need to do?

- Firms in scope of CRR should model the impact of these amendments on capital and leverage ratios.
- The revised treatment of prudently valued software assets may have an impact on firms' investment in technology. Once the EBA finalises the RTS, firms should assess which software assets will be afforded the preferential treatment and factor this into their IT investment plans.
- Once the Brexit transition period ends on 31 December 2020 EU rules will no longer apply in the UK. The PRA is assessing the impact of those parts of the CRR quick fix which are not derived from the Basel Committee agreement and will assess whether measures under Pillar 2 are necessary. Firms should look out for further announcements from the PRA and be prepared for bilateral supervisory discussions on the impact of these amendments on financial resilience.

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