The regulatory and supervisory response to the COVID-19 crisis

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Abstract

The impact of COVID-19 represents an unprecedented international challenge and the most severe test of the resilience of the banking industry – and of the financial system as a whole – since the global financial crisis of 2008. The rapid and resolute response of international and European Union institutions and fora with financial regulatory and supervisory responsibilities has been aimed to coordinate the actions taken at national level and, thus, to help safeguard the orderly functioning and stability of the financial system, as well as the uninterrupted financing of the real economy. This response has spanned different areas, including microprudential, accounting and macroprudential policies. This article provides an overview of the standards, guidelines and measures promoted since March 2020 by different authorities. The wide-ranging regulatory and supervisory reaction to COVID-19 is emerging as a distinctive feature of the management of this crisis, which, far from over, has led to an environment of heightened uncertainty and risks for the financial system which warrants further monitoring and a continued policy response.

1 Introduction

With the outbreak of COVID-19, the global financial system faces an unprecedented crisis, with an as yet unknown macroeconomic impact.[1] **However, it is in a comparatively more robust position than in the 2008 global financial crisis, largely owing to the reforms promoted by the G20 over the last decade.** These measures have been developed and instrumented at global level through the Financial Stability Board (FSB), the different organisations responsible for international regulatory standards, including the Basel Committee on Banking Supervision (BCBS), and the organisations responsible for accounting standards [the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB)]. One notable example is the BCBS Basel III standards, which have led to an increase in the banking sector's capital and liquidity levels and have been key to guaranteeing that the sector acts as a mechanism for absorbing, rather than amplifying, the shocks triggered by the pandemic.

The action taken to date by various institutional authorities has addressed the different dimensions of the impact of the crisis. Governments and central banks

1 For example, in June, the International Monetary Fund (IMF) estimated a drop of 4.9% in global GDP in 2020 [International Monetary Fund (2020)]; in September, the Banco de España estimated a decrease of between 10.5% and 12.6% in Spanish GDP [Banco de España (2020c)].

in numerous jurisdictions have taken fiscal and monetary policy measures to tackle the various impacts on productive sectors, households and consumers and on the financial markets and access to liquidity. Meanwhile, market authorities have taken the required measures to try to prevent disruptions in the financial markets in the aftermath of the pandemic.

The banking regulatory and supervisory authorities remain watchful and continue to explore additional action within the remit of their competences, both at international level and in the European Union (EU). In the short term, the measures taken have centred on ensuring that banks continue lending to households and solvent firms, thereby trying to mitigate part of the economic impact. Efforts have also been made to reduce the operational burden both for supervisors and regulators and for banks, thus ensuring that the resources available are focused on the financial stability priorities arising from the pandemic crisis. The challenges facing the authorities in the medium and long term will revolve around continuing to monitor and assess the changes in the financial and operating risks to the banking system, with a view to ensuring the banking sector's resilience and financial stability.

This article focuses on describing the banking sector regulatory and supervisory response to date. Section 2 briefly explains the motivation for the authorities' response and the importance of international coordination. Section 3 describes, from a microprudential, accounting and macroprudential standpoint, the measures adopted with the aim of ensuring that the banking sector continues to play its role in mitigating the impact of the pandemic by lending to households and solvent firms. Section 4 briefly explains the measures aimed at alleviating the operational burden of both banks and authorities. Lastly, Section 5 draws some initial conclusions, within the existing climate of uncertainty following the early months of the pandemic's impact, and describes future areas of focus.

2 Why is a response needed from regulatory and supervisory authorities? The role of international coordination

The COVID-19 impact is an exogenous shock to the banking sector, yet its possible consequences could threaten the stability of the financial system as a whole and of the banking sector in particular. Despite the response from governments and central banks, regulatory and supervisory authorities play a very important role in coping with this crisis. There are at least three reasons for this: i) to alleviate the operational burden so that resources are correctly prioritised; ii) to ensure that the banking sector helps to absorb the fallout of the crisis; and iii) to guarantee the financial system's resilience.

One of the lessons of the 2008 global financial crisis is the importance of international coordination for safeguarding financial stability in an increasingly

interconnected world. The consequences of the pandemic are admittedly heterogeneous, depending on its incidence at national level (not only in health terms, but also on the basis of the productive structure and economic dependence of the most affected sectors) and national responses need to be suitably flexible. However, given the global dimension of the financial system in general and of the banking sector in particular, efforts must be made to guarantee cooperation so as to ensure a level playing field and avoid fragmentation at international level.

Some examples of this coordination can be found in the activities undertaken by the FSB and the BCBS since the initial phase of the pandemic. The FSB has monitored the situation and its impact on global financial stability on an ongoing basis and has also established principles underpinning the response from the authorities [Financial Stability Board (2020a)]. These principles state that the authorities recognise the flexibility built into standards to sustain the flow of financing to the real economy, to support smooth market functioning and to accommodate robust business continuity planning. However, they also emphasise that authorities' actions will be consistent with maintaining common international standards that guarantee the resilience needed of the financial system while preserving an international level playing field. The G20 has given its political backing to this report and requested that the measures adopted and their consistency with standards be monitored; this work has been undertaken by the FSB together with the various organisations responsible for international standards. As an initial conclusion, most of the measures adopted make use of the flexibility built into international standards and, where they go further, the changes have in general been temporary.[2] In turn, the BCBS, in appropriate coordination with different organisations and authorities, is adopting a series of response measures backing the measures taken at national level, in order to avoid international fragmentation.

3 Measures taken to encourage banks to continue lending to households and solvent firms

As explained above, given its causal nature, COVID-19 is an exogenous shock affecting both economic growth and the financial system. Nevertheless, the ultimate impact and severity are, in some way, endogenous vis-à-vis the behaviour of the banking sector, in particular as regards the provision of credit and other critical services to households and solvent firms. In this context, it is essential that the banking sector mitigates the crisis and that, to the extent possible, banks are prevented from adopting a defensive stance by deleveraging. This section describes the microprudential, macroprudential and accounting measures taken by regulators to date in this regard.

2 Financial Stability Board (2020b). One example in this regard would be the exclusion of central bank reserves and government bonds from the leverage ratio in the United States and Canada, where no adjustment or recalibration of the ratio in response to this exemption, as envisaged in the Basel III framework, has been introduced.

3.1 Prudential treatment of the extraordinary measures adopted by governments

Regulators have attempted to ensure that the reduction in risk derived from these extraordinary measures is fully recognised in the calculation of capital requirements. Governments and banks in multiple jurisdictions have launched extraordinary measures to soften the economic and financial impact of COVID-19, in particular to ease the temporary liquidity stress of firms and households owing to the sharp decline in activity. These measures include a range of payment moratoria (temporary suspension of loan payments covering just the principal or also interest) and public guarantees for corporate sector lending. In this connection, regulators have attempted to ensure that prudential regulations are neither a deterrent to adopting these measures nor detrimental to their positive effects.

At international level, the BCBS has published technical guidelines clarifying the prudential treatment of guarantees and moratoria. For example, banks will be able to apply sovereign risk weights to exposures with public guarantees. Banks may also exclude payment moratoria when classifying exposures as non-performing due to arrears[3] or as forborne.[4]

At European level, the treatment agreed by the European Banking Authority (EBA) for payment moratoria is particularly interesting. In line with the BCBS, the EBA advocated a pragmatic and flexible treatment of moratoria in its statement on 25 March 2020 [European Banking Authority (2020b)]. Moreover, it anticipated that it would draw up more detailed guidelines on this subject. The guidelines on moratoria [European Banking Authority (2020c)] were negotiated and developed with the swiftness and urgency demanded by the situation and were published just a few days later on 2 April 2020. In these guidelines, the EBA specifies the prudential treatment applicable to the moratoria and sets the criteria that they must fulfil in order to qualify for this treatment.

With regard to the prudential treatment of the moratoria, the EBA has appropriately combined flexibility with sound and prudent management of default recognition. These guidelines clarify the application of the prudential definitions[5] of “default” and “forbearance” to exposures subject to eligible moratoria.

3 A credit transaction is classified as non-performing due to arrears when it has amounts more than 90 days past due.

4 Basel Committee on Banking Supervision (2020a). The Committee also gave indications on accounting standards; see Section 3.4.

5 The definition of default is given in Article 178 of Regulation (EU) No. 575/2013 on prudential requirements for credit institutions and investment firms [Capital Requirements Regulation (CRR)] and developed in the EBA Guidelines on the application of the definition of default (EBA/GL/2016/07). The definition of forbearance is detailed in Article 47b of the aforementioned Regulation.

Box 1

MORATORIUM ELIGIBILITY CRITERIA FOR THE PURPOSES OF THE EUROPEAN BANKING AUTHORITY GUIDELINES ON LEGISLATIVE AND NON-LEGISLATIVE MORATORIA ON LOAN REPAYMENTS APPLIED IN THE LIGHT OF THE COVID-19 CRISIS

1 The moratorium must be based on national law (legislative moratorium) or be a private initiative in which an institution adheres to an agreement reached by the banking sector, or a material part thereof (non-legislative or private moratorium). Therefore, neither private moratoria established individually by institutions nor those negotiated with clients on a case-by-case basis are eligible.

2 The moratorium has to apply to a broad range of clients, and any criteria for defining the moratorium should allow the borrower to take advantage of it without an ex ante assessment of their ability to pay.

3 The moratorium may only entail changes to the schedule of payments, namely by suspending, postponing or reducing the payments of principal amounts, interest or of full instalments, for a predefined period of time.

4 The moratorium must offer the same conditions to all the exposures subject to it. Acceptance is not obligatory for borrowers.

5 The moratorium does not apply to new loans granted after the date when the moratorium was announced.

6 The moratorium must have been launched in response to the COVID-19 crisis and applied before 30 June 2020. Subsequently, on 25 June 2020, the European Banking Authority extended this deadline to 30 September.

As regards the prudential definition of default, instalments subject to the moratoria are not considered past due. Classifying an exposure as defaulted generally entails an increase in capital requirements. This classification can be made for two reasons: automatically, when a borrower is past due more than 90 days on a material obligation; or at the bank’s discretion, when it considers that there are reasonable doubts that the borrower will service their debts. This second criterion is known as ‘unlikely to pay’.

The guidelines interpret that, when an exposure is subject to an eligible moratorium, the instalments in question will not be considered past due, and the counting of days past due will be based on the new schedule resulting from application of the moratorium. It is worth clarifying that, with this interpretation, the EBA merely extends a criterion for legislative moratoria, already set out in its guidelines on the definition of default, to all eligible moratoria.

However, for the duration of the moratorium, banks must continue to analyse their borrowers’ creditworthiness and unlikeliness to pay in accordance with their relevant prevailing general policies. When banks conclude that borrowers are unlikely to pay, they will be classified as defaulted. It is therefore a matter of distinguishing between those borrowers with viable businesses that are experiencing one-off liquidity difficulties owing to government-imposed lockdowns and those with fundamental solvency problems. For the latter group, the guidelines on moratoria are clear: banks should not delay classification as defaulted or the recognition of losses.

As regards the definition of forbearance, transactions subject to an eligible moratorium should not automatically be reclassified as forborne. In accordance with prudential regulation, banks are obliged to inform the supervisor and the market of those exposures that have been subject to forbearance measures. The definition of a forbearance measure is a concession by a bank towards a borrower that is experiencing, or is likely to experience, difficulties in meeting its financial commitments. In other words, in order to be reclassified as forborne, a borrower has to be experiencing financial difficulties.

Following the guidelines, transactions subject to an eligible moratorium should not automatically be reclassified as forborne. This flexibility has been allowed – among others – because eligible moratoria are granted as part of a general scheme to borrowers meeting certain criteria, without said borrowers being subject to an individual ex ante assessment of their creditworthiness.

Moreover, as the transactions are not necessarily considered forborne, these exposures would also be exempt from the distressed restructuring test. This test is covered in the aforementioned guidelines on the definition of default and the exemption of these transactions is an important nuance, as otherwise many would possibly need to be reclassified as defaulted.

Finally, it should be noted that the original deadline of these guidelines was foreseen for 30 June 2020. However, the EBA decided to extend it for three additional months, until September. As this date approached, the EBA rejected a new extension, what means that moratoria granted after that date cannot be subject to the provisions of the guidelines.

3.2 Other microprudential measures adopted at European level

In addition to the measures aimed at clarifying the prudential treatment of the extraordinary measures, European authorities undertook an unprecedented urgent review of banking legislation on capital requirements, known as the 'CRR quick fix'. This reform responds to the aim of guaranteeing that the banking sector continues to support firms and households by lending. Details of some of these changes, together with the related rationale and expected impacts from a conceptual standpoint, are as follows:[6]

6 These measures also include a revision of the prudential treatment of provisions for expected losses (see Section 3.4) and other changes not detailed in this article. For example, a temporary favourable treatment has been reintroduced for exposures to central governments issued in the domestic currency of another Member State for the purpose of calculating risk-weighted assets and large exposures; this treatment was previously allowed under European regulation, before its term expired. The main objective is to enable European countries outside the euro area to address potential difficulties in local currency issuances, given the impact of COVID-19.

Prudential filter

Movement in the financial markets can trigger major changes in the fair value of assets, which in prudential terms may have a significant impact on capital levels.[7] In order to mitigate this sudden impact and help to absorb it gradually, a filter for gains/losses on certain financial instruments measured at fair value through other comprehensive income (FVOCI) has been reintroduced into European legislation. This filter will be applied to those assets on banks' balance sheets corresponding to central governments, regional governments or local authorities that are assigned a risk weight of 0% under the standardised approach.[8] It will be applied temporarily for a period of three years, with an initial percentage of 100% in 2020, declining to 70% in 2021 and 40% in 2022.

By temporarily filtering unrealised losses or gains arising from changes in the fair value of these assets, such changes would not automatically result in a consumption/increase of a bank's CET1. Nevertheless, as the changes allow banks to apply the filter and reverse this decision on one occasion, it could in fact mean that only capital decreases are removed and increases are admitted. Naturally, the impact will depend on the exposures to central governments recognised at FVOCI held by banks and on the intensity of the changes in their fair value.

Moreover, in order to guarantee that the market understands the effects of this filter and the transparency of the new requirements if it is applied, banks must disclose the capital ratios they would have had without its application.

Leverage ratio

When institutions use central bank liquidity facilities obtained by providing collateral, deposits at central banks are recognised within their assets, unless the funding is used for other purposes; the collateral also remains in their assets, resulting in an expansion of their balance sheet, which can tighten the leverage ratio.[9] Basel III already introduced the possibility of approving the exclusion of central bank reserves from the leverage ratio denominator in order to ease monetary policy implementation.[10] To apply this exemption, institutions are required to recalibrate the leverage ratio, in order to avoid releasing capital upon application of this exemption, and to disclose its impact on the leverage ratio to the market.

7 Changes in the value of instruments measured at fair value through other comprehensive income directly affect a bank's Common Equity Tier 1 (CET1) capital. Consequently, unrealised losses reduce banks' CET1, introducing volatility into the capital ratios.

8 Treated as exposures to the central government under Articles 115(2) and 116(4), excluding Stage 3 exposures.

9 Conversely, it does not affect the solvency ratio, as such deposits at central banks have zero risk weight.

10 And, specifically, to deter banks from deleveraging in order to maintain the leverage ratio owing to the effect on this ratio of using such central bank liquidity assistance.

The possibility of introducing this exemption was already provided for in European regulation. However, it entailed an adjustment to the requirement, offsetting any benefit from the exemption, with the adjustment varying over time, based on the volume of reserves. Via the ‘quick fix’, a series of amendments has been introduced enabling application of the exemption by preventing the full offset of the benefits. The amendments also allow the decision taken by the competent authority, in consultation with the central bank, to refer to a date prior to such decision.[11]

Revision of the prudential backstop for non-performing loans

The prudential backstop at European level for non-performing loans introduces minimum loss coverage levels for such exposures, based on specific timetables. The ‘quick fix’ adjustments introduced a permanent favourable treatment for exposures guaranteed by the “public sector”.[12] Specifically, for the part of the non-performing exposure guaranteed or insured by the “public sector”, a provision of 0% is permitted for the first seven years following classification as non-performing. This thus avoids a negative impact on banks’ solvency ratios in the event that exposures guaranteed by the public sector are classified as non-performing.

Early application of some 2021 measures

It is proposed to bring forward the date of application of the SME[13] and infrastructure[14] supporting factors and of the favourable treatment of loans to pensioners and employees with a permanent contract that are backed by the borrower’s pension or salary, both already envisaged in European regulation. Early application of the new prudential treatment of software assets (developed by the EBA through an RTS published in October 2020) is also proposed, to bring it forward to immediately following publication of the final document, rather than 12 months later as envisaged

11 This aspect is especially relevant in order to give the authority scope for decision-making and to prevent the adjustment from being reset if a renewal of the exemption for a period of more than one year is envisaged. Moreover, the measure prevents the adjustment from being based on a specific value of central bank reserves (which can show volatility) on a concrete day.

12 Understood as: central governments and central banks, regional governments or local authorities, multilateral development banks, international organisations with a risk weight of 0% and public sector entities eligible for a risk weight of 0% under Part Three, Title II, Chapter 2 [Articles 115(2) and 116(4) of the CRR], in accordance with Article 201(1)(a) to (e) of the CRR on eligible collateral for purposes of credit risk.

13 In the case of SMEs, in accordance with the CRR, the capital requirements for credit risk on exposures to SMEs have until now been multiplied by a factor of 0.7619 (only for exposures of less than €1,500,000). A factor of 0.7619 is now established for exposures of less than €2,500,000, and a factor of 0.85 for those exceeding this amount.

14 In the case of infrastructure, the supporting factor for exposures to entities that operate or finance physical structures or installations, systems and networks that provide or support essential public services is 0.75 provided that the exposure fulfils certain criteria defined in the CCR.

in European regulation. Amendments enabling favourable treatments as regards the leverage ratio for transparency and reporting purposes are also included.[15]

The purpose of bringing these dates of application forward is to anticipate measures entailing reductions in capital requirements, in addition to incentivising funding for certain economic sectors.

Adjustments to market risk requirements

The extreme volatility in the financial markets arising from the COVID-19 impact could have a significant impact on banks' capital requirements for market risk.[16] The 'quick fix' adjustments are aimed at providing some supervisory discretion for adjusting capital requirements, in exceptional circumstances and for individual cases, so as to exclude possible deviations occurring between 1 January 2020 and 31 December 2021, provided they do not result from deficiencies in the internal model. This adjustment prevents an increase in market-risk weighted assets and, therefore, a decrease in the solvency ratio.

In this regard, the EBA had already recommended applying supervisory flexibility in the qualitative part of the market risk multiplier for these requirements. With this same objective (i.e. eliminating negative capital impacts of excessive volatility in the financial markets), the EBA temporarily amended its technical standards on prudent valuation.

Amendment to the securitisation framework

Besides the 'quick fix', on 24 July, the European Commission published a new raft of legislative measures with targeted changes for capital markets, as part of the post-COVID-19 strategy. From a prudential regulation standpoint, the proposed amendments to the **securitisation framework** are particularly significant.

Securitisation is a tool that allows illiquid bank assets to be transformed into tradable securities. Although not risk-free, this tool is very useful both for originator institutions (normally credit institutions) and for investors. It enables originators to obtain

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15 Specifically, the exclusion of central bank reserves from the denominator and the specific adjustment enabling the netting of claims and payment obligations on transactions pending settlement in the leverage ratio, both of which are already envisaged in European regulation for when the leverage ratio requirement enters into force (June 2021).

16 Under the internal model approach, capital requirements for market risk are increased by a qualitative multiplier and a quantitative multiplier, which depends on the number of overshootings. Overshootings are the differences obtained in the comparison of the internal model output with the P&L (actual and hypothetical). With this change, overshootings in 2020 and 2021 would be excluded, preventing an increase in capital requirements for market risk; the CRR currently permits supervisors to only partially disregard overshootings, specifically those derived from a comparison with the actual P&L, not the hypothetical P&L.

financing and/or manage existing exposures on their balance sheet, freeing up capital that can be used to grant new loans. At the same time, market participants can access new investment opportunities, contributing to an appropriate risk-sharing across the financial system as a whole.

The amendments proposed by the European Commission are aimed at strengthening the role that securitisation can play in channelling credit to the economy, thereby contributing to the post-COVID-19 economic recovery. First, it is proposed to extend the simple, transparent and standardised (STS) framework in place for traditional securitisation[17] to balance-sheet synthetic securitisations,[18] achieving a beneficial prudential treatment for the senior tranche retained by the originator on its balance sheet. Second, and in line with the BCBS' recent consultative document, a series of measures aimed at removing the regulatory obstacles identified in non-performing exposure securitisations is proposed.

At the cut-off date for this article, all the securitisation amendments mentioned are pending discussion and approval by the European Parliament and by the Council before their entry into force.

3.3 Use of capital and liquidity buffers

The Basel III framework introduced capital buffers and, in addition, a short-term liquidity requirement that also functions as a buffer (this is not a minimum requirement, but rather can be used in situations of stress). However, as experience with this framework does not yet cover a full financial cycle, one of the issues under debate is the usability of these buffers and the obstacles which might limit such usability (see Box 2).

Against this backdrop, the authorities have issued recommendations on their use at national, European and international level. For example, the BCBS has reiterated in various statements the purpose of the capital and liquidity buffers and the possibility of using them adequately to support the economy and absorb the current shock. It has also clarified the expectation that supervisors should give banks sufficient time to restore their capital buffers, taking into account both economic and market conditions and each bank's individual circumstances.

At European level, on 12 March 2020 the EBA issued a statement encouraging supervisors and regulators to make use of the flexibility embedded in the European

17 A traditional securitisation is one in which securitised exposures are transferred to a securitisation special purpose entity (SSPE), transforming them into tradable securities.

18 An on-balance-sheet synthetic securitisation involves transferring the credit risk of a set of loans, typically large corporate loans or SME loans, by a credit protection agreement where the originator buys credit protection from the investor. The credit protection is achieved by the use of financial guarantees or credit derivatives while the ownership of the assets remains with the originator.

Box 2

USABILITY OF CAPITAL BUFFERS: ISSUES AND MEASURES ADOPTED

The objective sought by the Basel III buffers framework is two-fold:

— To provide banks with greater flexibility to absorb losses in times of stress, increasing their resilience and mitigating negative macroprudential externalities such as deleveraging.

— To prevent an imprudent reduction in capital by setting constraints on distributions.

Basel III requires using Common Equity Tier (CET1) for three buffers: a capital conservation buffer (2.5%), an additional buffer (between 1% and 3.5%) for global systemically important banks (G-SIBs) based on the degree of systemic importance, and a countercyclical capital buffer (CCyB) which the macroprudential authorities will activate and deactivate based on developments in the economic cycle. At European level, this is known as the combined buffer requirement, which includes the systemic risk buffer.[1]

It is established that failure to comply with this requirement will give rise to automatic restrictions on the distribution of profits (e.g. payment of dividends, payment of coupons on Additional Tier 1 (AT1) instruments, share buy-backs and payment of bonuses). Such restrictions will increase as greater use is made of the buffer.[2] This automatic mechanism is known in European Union (EU) regulations as the Maximum Distributable Amount (MDA), which determines the maximum amount to be distributed for each CET1 level if the capital buffers have not been met.

The ability to use buffers depends on their design, investor and supervisor expectations and banks' incentives and internal risk management [Borio and Restoy (2020)]. Against this background, it is essential to understand what obstacles there are to usability and how to address them:

1 One factor determining the possible use of capital buffers is banks' own internal risk management and prudence in anticipating future losses. In a setting of negative macro-financial prospects, banks might not wish to use buffers in view of the possibility of having to deal with losses or increases in capital requirements in response to greater risks materialising.

2 In connection with the foregoing, there is a potential stigma effect deriving from the market's pressure to maintain capital levels reflecting a specific strength of their solvency position, especially in situations of stress. Banks could also wish to avoid being "the first ones" to reduce their capital ratios if they perceive that the market might interpret this as a sign of weakness.

3 Another disincentive could occur where there is a lack of clarity about supervisory expectations relating to flexibility and time periods for capital restoration plans and their relationship with economic activity and the capital markets returning to normal. This factor is particularly important considering the expectations on the ability to restore capital in the future. Against a background of a negative economic outlook and downward pressures on profitability, compounded in some cases by the cancellation of shareholder remuneration, banks are facing potential constraints on their ability to restore capital, whether through profit generation or market issuances. In this connection, both at international level and certain authorities have stated that sufficient time will be provided for restoring capital based on the course of the pandemic and banks' specific circumstances [Basel Committee on Banking Supervision (2020)].

4 Finally, an area that might limit the usability of capital buffers is the possible stigma derived from the effect of automatic restrictions on distributions. These restrictions affect dividend payments, share buy-backs, coupons on AT1 instruments and variable remuneration. The stigma effect may be more pronounced in certain cases, such as the payment of dividends and of coupons on AT1 instruments. Variable remuneration may have a lower stigma effect in the market, but may have consequences on the ability to attract and retain senior management. As regards share buy-backs, although the economic effect is similar to that for dividend payments, there could be more flexibility as they are not perceived to be recurrent

1 The systemic risk buffer (SyRB) is a macroprudential instrument specific to EU regulations under which the designated authorities may impose a CET1 capital requirement to deal with non-cyclical systemic risks not covered by the CCyB or by systemically important institutions' buffers.

2 The conservation ratio depends on which quartile the CET1 ratio is in. The lower the quartile, the greater the conservation ratio and, therefore, the lower the distributable amount.

and, therefore, their cancellation can be expected to involve a smaller stigma effect, in relative terms. This practice is currently more common in the United States than in the EU.

As regards this last point, the Basel Committee on Banking Supervision has stated that using capital and liquidity resources to absorb the shock and support the real economy should take priority over discretionary distributions. The pattern of distributions in different countries is uneven internationally and different approaches have been adopted across jurisdictions.

In Europe, a general restriction on the payment of dividends and share buy-backs has been introduced. This helps in part to resolve the stigma arising from the automatic restriction on distributions. The European Banking Authority (EBA) urged banks not to pay dividends – whether in cash or in the form of shares –, or buy back shares, and to revise their remuneration policies, setting variable remuneration at a conservative level. This was a controversial decision, insofar as it could affect the market valuations of European banks, but it was necessary to preserve capital at banks and thus serve the economy's credit and liquidity needs. This EBA action was adopted in coordination with the European Central Bank (ECB). On 27 March 2020, the ECB recommended that banks under its supervision refrain from: i) paying out dividends for 2019 and 2020, at least until 1 October 2020, and ii) buying back shares to remunerate shareholders. There was no reference in the recommendation as to how variable remuneration was to be treated. However, on 28 July, when extending the previous recommendations until January 2021, the ECB also asked banks to be extremely moderate with regard to their variable remuneration policies.

Lastly, the obstacles identified in banks' use of capital buffers to absorb losses affect microprudential and macroprudential buffers in the same manner. From a macroprudential viewpoint, the countercyclical capital buffer is activated and deactivated by the authorities. Therefore, although failure to meet the requirement once the buffer has been activated gives rise to automatic constraints on distributions, if the authorities decide to reduce it (which, as explained in the previous section, was the case in most jurisdictions), the stigma associated with automatic distribution restrictions is resolved. This makes it more effective for the macroprudential authority to be able to reduce the calibration of a specific buffer rather than the alternative option of maintaining it, and encourages banks to consume it if necessary to absorb losses. The use of the conservation and systemic risk buffers is conditioned by the automatic distribution restriction mechanism.

regulatory framework to free up capital and thus mitigate the impact of COVID-19 on the banking sector. In particular, the EBA signalled P2G[19] as a countercyclical tool that could be used by supervisors to support lending.

In line with this recommendation, several supervisors provided their banks with the flexibility to operate temporarily below their P2G levels. In particular, on 12 March the European Central Bank (ECB) echoed this recommendation and asked banks to make use of the capital and liquidity buffers and, in particular, the capital conservation buffer, P2G and the liquidity coverage ratio (LCR) buffer. It argued that these instruments had been designed precisely to address situations such as the COVID-19 crisis. On 28 July the ECB committed to allow banks to operate below the P2G and the combined buffer requirement until at least end-2022, and below the LCR until end-2021.

19 In the EU the Pillar 2 requirements have two components: additional own funds requirements (P2R), covering risks or risk elements not covered by Pillar 1, and additional own funds guidance (P2G).

The issues relating to the use of buffers may affect both capital and liquidity. However, as a result of the stabilisation of activity in the financial markets, the possible tensions regarding the use of liquidity buffers are lower. The measures adopted by central banks provide banks with broad access to liquidity, making the use of the LCR less pressing.

3.4 Response within the scope of accounting standards

Following the declaration of the global pandemic by the World Health Organization (WHO) on 11 March 2020, numerous statements were made by accounting regulators and banking supervisors on the application of accounting standards.

These statements shared the goal of providing guidance on the application of the International Financial Reporting Standards adopted by the European Union (IFRS-EU).[20] More specifically, they focused on the application of IFRS9-EU criteria on financial instruments, on the classification of credit risk transactions for the purpose of estimating credit loss coverage (known as "provisions") and on how to carry out such estimates.

IFRS9-EU was first applied relatively recently (in January 2018). Among other important changes, this international standard introduced a new approach for estimating provisions, known as the "expected loss" approach. One of the main features of this approach is the need to consider information about future conditions in the estimate. The statements mentioned above sought to mitigate the risk of an inadequate application of the new expected loss approach having procyclical effects.

When a high-level summary is made of the content of such statements, it is generally noted that they guide banks to make use of the flexibility envisaged in the accounting standards. With this formula, the intended message is that the automatic application of some of the factors and assumptions that have been used to estimate expected losses since the initial application of IFRS9-EU has proved to be inadequate for the situation arising from COVID-19, and even going forward, and that there are alternative practices within the framework established in the international standard.

The situation deriving from COVID-19 gave rise to two basic problems for banks when applying the IFRS9-EU framework:

20 IFRS are also the accounting framework of reference at global level, with the exception of the United States, which has its own specific accounting rules. These standards are prepared by the IASB and they became binding for the EU through the adoption procedure established in Regulation (EC) No. 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards (IAS Regulation).

— **Difficulties in classifying loans by credit risk** (stages[21]): the measures to contain the spread of COVID-19 led, to a greater or lesser degree, to the confinement of the population and the shutdown of economic activity. In this situation, households and firms whose ability to pay had been adequate until then suffered a sudden reduction (or even disappearance) of their recurrent sources of income. Banks had to analyse the extent to which sudden and short-term changes in a borrower's situation gave rise to significant impacts on their creditworthiness over the life of the loan. Performing this analysis has been difficult in the situation deriving from COVID-19.

— **Difficulties in estimating credit loss provisions:** during 2020 H1 there was much uncertainty about the impact of both containment and support measures on economic activity. Although there was undoubtedly going to be a decline in economic activity, there was a high degree of uncertainty about its magnitude. To paraphrase Donald Rumsfeld, the negative impact of the coronavirus on economic activity was a "known unknown".[22] This has complicated the application of the expected loss approach.

At euro area level the ECB spearheaded the adoption of different prudential measures relating to credit institutions' capital and liquidity requirements, in addition to providing guidance on how to apply IFRS9-EU in the situation deriving from COVID-19. In the latter case, the aim was to mitigate the risk of inadequate practices in classifying loans and estimating provisions having procyclical effects in this setting. In the field of accounting, the first and most impactful communication was a press release on 20 March 2020 regarding further flexibility for banks in response to the coronavirus.

At EU level, on 25 March 2020 the European Securities and Markets Authority (ESMA) issued a public statement entitled "Accounting implications of the COVID-19 outbreak on the calculation of expected credit losses in accordance with IFRS 9". On that same date the EBA published a statement on the application of the prudential framework regarding default, forbearance and IFRS9 in light of COVID-19 measures.

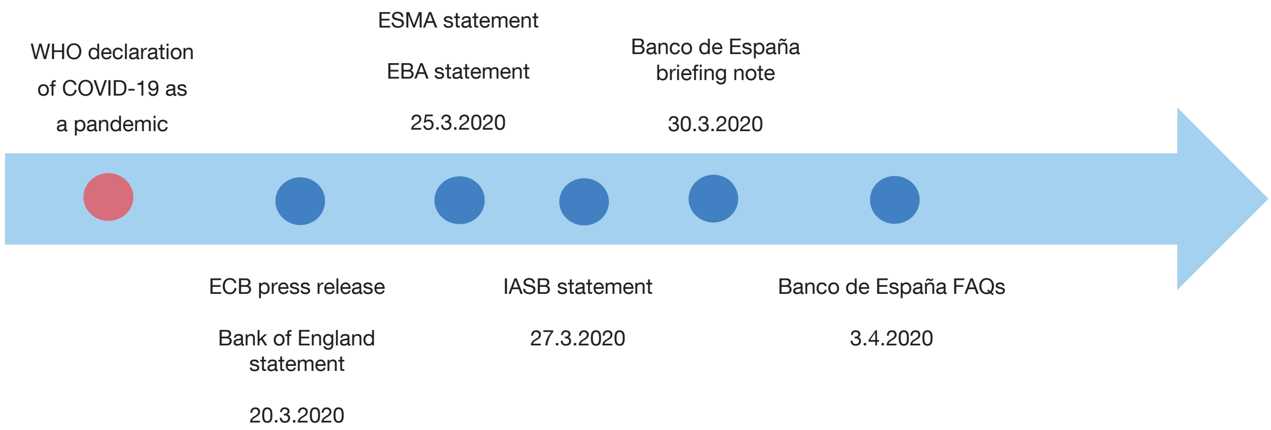
On 27 March 2020, the IASB published a statement entitled "IFRS 9 and COVID-19".[23] In it the IASB recalled that the application of IFRS9 requires expert judgement

21 To estimate expected losses under IFRS9 loans are classified into one of three categories: Stage 1, Stage 2 and Stage 3, with the highest credit quality relating to Stage 1. In general, as the classification of a specific loan worsens, the associated expected loss increases.

22 On 12 February 2002 the then United States Secretary of Defence Donald Rumsfeld stated the following in response to a question about Iraq and weapons of mass destruction: "There are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns—the ones we don't know we don't know."

23 The full title is "IFRS 9 and COVID-19. Accounting for expected credit losses applying IFRS 9 Financial Instruments in the light of current uncertainty resulting from the COVID-19 pandemic".

Figure 1
MAIN ANNOUNCEMENTS RELATING TO ACCOUNTING ISSUES
2020 H1



SOURCE: Devised by authors (drawing on public information).

and that this standard allows and requires banks to adjust their practices in estimating credit loss provisions to different circumstances. Further, it stated that certain linkages and assumptions underlying the way these provisions had been estimated to date might no longer hold in the situation deriving from COVID-19 and that banks should not continue to apply their existing practices automatically.

Lastly, on 30 March 2020 the Banco de España, as the national accounting regulator for credit institutions, published a briefing note on the use of the flexibility envisaged in the accounting standards in view of the shock caused by COVID-19. On 3 April 2020 this briefing note was supplemented with the publication of an FAQs document, which was updated on 30 April 2020.

The main messages conveyed in the foregoing statements will be discussed below, starting with those relating to the classification for estimating provisions for loans due to credit risk and continuing with those relating to calculating provisions.

As stated previously, the containment measures adopted by governments to limit the spread of the coronavirus have had severe consequences on economic activity. However, the impact of the situation caused by COVID-19 on a firm's operating results or on household income while the containment measures are in force does not have to be permanent.

The liquidity difficulties of many borrowers will fully or partially disappear when such containment measures are lifted. Also, the exceptional and significant public support measures aimed at mitigating the temporary liquidity difficulties of borrowers affected by the situation deriving from COVID-19 should be taken into account.

In its statement, ESMA recalls that the presumption that exposures with amounts past due more than 30 days should be reclassified from Stage 1 to Stage 2 (which generally involves an increase in the level of provisioning for the transaction) **can be rebutted.** ESMA's message is that, in the context of COVID-19, the fact that amounts may be past due should not be automatically applied when classifying exposures into stages.

ESMA also recalls that significant increases in credit risk since origination, which lead to classification in Stage 2, are identified by considering the entire expected life of the transaction. Consequently, banks must analyse the extent to which sudden and short-term changes in a borrower's situation give rise to impacts over the entire life of the transaction. It also emphasises that moratoria and other measures allowing payments to be postponed that are granted as a result of the situation generated by COVID-19 need not automatically lead to the identification of a significant increase in credit risk. In other words, a warning is issued against an automatic linkage between the change in the contractual conditions of a loan and its reclassification to Stage 2.

Along the same lines, in addition to the aforementioned briefing note, the Banco de España incorporated a change to Annex 9 of Circular 4/2017[24] by means of an urgent procedure. The purpose of this change was to break the automatic link that existed until then between a forborne transaction and its reclassification as other than performing (i.e. other than Stage 1).

Forbearance is the modification of the contractual conditions of a loan as a result of the borrower's financial difficulties. Prior to the change in Annex 9 of Circular 4/2017, it was assumed that forbearance automatically meant that there had been a significant increase in credit risk (leading to classification in Stage 2) or credit impairment (leading to Stage 3). The situation deriving from COVID-19 evidenced that this assumption did not necessarily hold true either in this exceptional situation or going forward.

The fact that the borrower is suddenly experiencing temporary financial difficulties does not necessarily mean that there has been a significant increase in credit risk considering the entire expected life of the transaction. Even in the event that there

24 This circular establishes the accounting regime applicable to Spanish credit institutions in their individual financial statements. Its full name is Banco de España Circular 4/2017 of 27 November 2017 to credit institutions on public and confidential financial information rules and formats. The criteria included in this circular on the accounting treatment of financial instruments are in line with those of IFRS9-EU (an international standard that is directly applicable to the consolidated financial statements of practically all banks). Annex IX of Circular 4/2017 on credit risk analysis, allowances and provisions implements the expected loss approach of IFRS9-EU.

has been such an increase, it may be reversed before the minimum period of two years during which forbearance must be identified as such has elapsed. Therefore, it should be possible to reclassify the loan as performing before the forbearance ceases to be flagged as such.

Following the change, under Annex 9 forbearance now works as a rebuttable presumption that there has been a significant increase in credit risk. A transaction may continue to be classified as performing if the bank justifies that no event evidencing a significant increase in credit risk has been identified at the time of forbearance.

Considering all the above, in their financial statements for 2020 Q1 and Q2, banks were not forced to automatically reclassify to a “worse” stage, in terms of credit quality, loans with amounts between 30 and 90 days past due, those granted to borrowers who had experienced a sudden decrease in income or those whose contractual conditions had been modified to facilitate payment by borrowers affected by the situation deriving from COVID-19. Banks thus had more headroom to compile and analyse information on lending transactions in order to identify those where liquidity constraints had been temporary and did not entail a significant decrease in credit quality.

In a situation such as that arising from COVID-19, general factors such as loans with amounts more than 30 days past due or whose conditions have been changed may not constitute sufficient evidence of a significant decrease in credit quality. Consequently, if a transaction is to be classified correctly it might be necessary to analyse additional risk factors in order to calculate the magnitude of the decrease in the debtor’s recurrent income or determine whether such decrease will persist over time.

One of the phenomena to be contended with when the correct functioning of a system is being sought is that known as “tight coupling”. This term makes reference to the need to complete many closely-linked processes in little time; in these cases, an anomalous functioning is likely to arise in situations of stress which would not occur if more time were available to carry them out. The aforementioned measures regarding classification by credit risk made it possible, in the COVID-19 crisis, for banks not to have to make decisions in haste, thus reducing the risk of adopting erroneous decisions, which is a key issue given the importance financing decisions have for households and firms.

As regards the aforementioned estimation of credit risk coverage (provisions) under the expected loss approach of IFRS9-EU, information about future conditions must be taken into account to determine whether and to what extent it is necessary to adjust the historical information on borrowers’ payment behaviour and on losses observed on credit transactions. The information about future conditions taken into account by banks generally consists of forecasts of future macroeconomic variables.

Although the situation resulting from COVID-19 was undoubtedly going to lead to a decline in economic activity, there was a high degree of uncertainty about the magnitude of such impact during 2020 H1. In this situation of extreme uncertainty, it was immensely difficult to generate macroeconomic scenarios and assign probabilities to them.

In its statement, the IASB noted that banks would have to take into account the effects of the containment and support measures adopted when assessing future conditions. Given that in this context it would be very difficult to do this any other way, the IASB explained that banks would be able to make adjustments to the results obtained from their expected loss models in order to consider both effects. The idea was that after some time, when the situation began to stabilise, banks would be able to update their macroeconomic scenarios and associated probabilities. This message sought to promote a practical, rather than dogmatic and complex, approach to applying the standard.

Another feature of the IFRS9-EU expected loss approach is the use of the probability of default over the entire life of the transaction to estimate provisions for Stage 2 transactions.

Against this backdrop, the ECB recommended that banks give a greater weight to longer-term, more stable, forecasts, based on historical performance. The effects of the volatility generated in an environment subject to frequent changes as new information became available would thus be mitigated.

Lastly, together with moratoria, the other measure frequently resorted to was the granting of public guarantees for certain lending transactions; for example, the guarantee facilities of the Official Credit Institute (ICO) in Spain. In these cases, the ESMA statement highlights that the amount of the provision associated with the transaction may be reduced owing to the effect of these guarantees. Insofar as the public sector guarantee specifically covers the failure of a borrower to make payments, the amount of the expected loss associated with the transaction will be reduced.

3.5 Prudential treatment of provisions

With the first-time application of IFRS9-EU, the BCBS resolved to introduce at the international level the possibility of deferring the potential impact of provisions on banks' regulatory capital over time. Two components were distinguished: a static component, for the increase in provisions at the date of entry into force of IFRS9-EU, and a dynamic component, for the difference between the provisions for exposures classified in Stages 1 and 2 at each calculation date and those recorded as at 1 January 2018. These transitional arrangements allowed adding, in decreasing percentages, a portion of these provisions to the highest-quality capital (CET1) over a period not exceeding five years. This adjustment to regulatory CET1 is called “add-back”.

The effects of the pandemic may result in an increase in provisions for expected losses, with the consequent impact on capital. For this reason, the Basel Committee resolved to revise these transitional arrangements to provide flexibility and help such impact fade over time. Specifically, jurisdictions are allowed to incorporate these transitional arrangements into their regulation, even if they had not done so previously, and provide flexibility for banks to use the most favourable approach (dynamic or static). As regards the design, jurisdictions are allowed to increase the adjustment coefficient to 100% during 2020 and 2021 (although they may also maintain the existing percentage if they consider it appropriate), resetting the transitional period, which would therefore be extended once again to five years. Finally, the use of alternative methodologies for calculating the impact of the entry into force of expected loss accounting is allowed.

Adjustments introduced at European level with the “quick fix”

In line with the BCBS, within the European package commonly known as the “quick fix”, the EU authorities revised the transitional arrangements for provisions for expected losses in the prudential framework. First, the arrangements for the dynamic component were revised, splitting it into two: i) increase in provisions between 1.1.2018 and 31.12.2019, which will continue to be subject to the existing transitional arrangements;[25] and ii) increase in provisions from 1.1.2020 (which could be associated with those deriving from the impact of COVID-19), for which the arrangements are revised. Specifically, the proposal consists of resetting the transitional period for the latter (extending it once again to five years) and revising the percentages of recognition in CET1, starting at 100% in the first two years, with a linear phase-in during the following three. This change will allow banks to continue recording the provisions required without consuming regulatory capital during the first two years – progressively increasing consumption over the following three years –, although they would be accounted for in the income statement and in the net book value.

The impact of this measure will largely depend on the classification of exposures in the different IFRS9-EU stages. If an exposure is reclassified to Stage 3 or derecognised owing to write-offs, these provisions cease to count for the transitional arrangements. The new dynamic component has a two-fold benefit for exposures classified in Stage 1 and Stage 2. First, the add-back applicable to the stock of provisions increases from 70% to 100% from 1.1.2020, lengthening the time frame.

25 70% in 2020, decreasing to 0% in 2023.

Second, banks are allowed to only take into account the change in the stock of provisions in 2018 and 2019 if they entail a benefit in the calculation of the dynamic component. In other words, their effect would only be taken into account if they increased, thus preventing potential falls in the stock in 2018 and 2019 from offsetting or reducing the benefits of the new transitional arrangements.

3.6 The macroprudential policy response

The aim of macroprudential policy is to mitigate preventively systemic risks that might affect financial stability. The authorities entrusted with macroprudential policy for the banking sector have a macroprudential toolkit that is provided for in domestic regulation. The tools are to be used on the basis of the financial system's cyclical and structural circumstances in each jurisdiction.

With the adoption of Basel III, the banking authorities of the world's main jurisdictions – including the EU and all its Member States – have had at their disposal since 2016 the countercyclical capital buffer (CCyB) and capital buffers for global systemically important institutions and other systemically important institutions (the G-SII and O-SII buffers). EU law provides for additional tools such as the systemic risk buffer and the possibility of setting higher risk weights for credit exposures owing to financial stability considerations. In turn, a significant number of EU and non-EU countries have, in their domestic legislation, conferred on their authorities a supplementary macroprudential toolkit with which to strengthen their ability to act. These tools include limits on and conditions for lending by credit institutions, such as the loan-to-value (LTV) ratio limits.

The CCyB is the macroprudential tool *par excellence* since its aim is to shore up banks' solvency, particularly where the macrofinancial situation is favourable, before systemic risks materialise. Credit institutions are required to build up the CCyB during expansionary periods so that it can be released during a subsequent contractionary phase. In this way, the CCyB strengthens the banking system's solvency during growth phases, which is when risks usually build up, and helps mitigate the decline in the flow of new lending to the economy when these risks materialise. Consequently, the CCyB helps increase credit institutions' capacity to withstand potential future losses. Releasing the CCyB in recessionary environments contributes to smoothing credit cycle fluctuations, which in turn could dampen the downswing during recessions. The national macroprudential authorities set the CCyB rate via a quarterly announcement of the buffer's required size, expressed as a percentage of risk-weighted assets of the credit exposures associated with the jurisdiction.[26]

26 The CCyB rate tends to be set between zero and 2.5% (calibrated in steps of 0.25 percentage points). A CCyB rate in excess of 2.5% should be acknowledged expressly by the macroprudential authorities of other jurisdictions

After COVID-19 was declared a pandemic on 11 March 2020, the national macroprudential authorities swiftly announced several measures. In tandem, European and global bodies issued statements calling for coordinated collective action. The national authorities' reactions were shaped by their respective pre-COVID-19 macroprudential requirements. Broadly speaking, these announcements highlighted the importance of communication and transparency when designing macroprudential policies and the extraordinary need to signal to all economic and social agents the macroprudential authorities' willingness to adopt measures that soften the adverse and uncertain impact of COVID-19.

Table 1 contains the CCyB-related macroprudential measures announced in response to COVID-19. Overall, 15 jurisdictions, most of which European (since Europe has been the most active user of this tool in recent years), have released the CCyB. In most cases, the CCyB has been released in full – reverting the rate to 0% – and, where applicable, the CCyB announcements made over the immediately preceding 12-month period which at that point had not yet become effective have been revoked. By contrast, a few jurisdictions have opted to either partially reduce the CCyB or release it in stages. To date, only one jurisdiction (Luxembourg) has decided not to change its positive CCyB rate. Spain has not cut the CCyB rate because it was already set at 0% at the onset of the crisis owing to the lack of obvious signs of a build-up of cyclical systemic risks pre-COVID-19.

Table 2 summarises the other macroprudential measures announced in response to COVID-19. A total of nine jurisdictions have adopted macroprudential measures adjusting the implementation of previously announced requirements. Six jurisdictions reduced their structural buffers (such as the systemic risk buffer or the O-SII buffer) completely or selectively on an institution-by-institution basis. While both buffers are designed for withstanding non-cyclical and/or structural risks, authorities have a high level of discretionality as regards their activation and deactivation. This has helped to facilitate their release. Notably, no jurisdiction has lowered the G-SII buffer.[27] In addition, the existence of a minimum positive O-SII buffer rate, decided by the ECB for application in the euro area [European Central Bank (2016)], appears to have curbed the adoption of further measures related to this tool, although two jurisdictions (Cyprus and Portugal) have decided to temporarily interrupt the gradual build-up of this buffer. During this time, Spain has required five systemically important institutions to build up macroprudential

so that their institutions take it into account when calculating their institution-specific CCyBs. Based on the CCyB rates of each jurisdiction, banks must calculate the capital requirement applicable to them at the consolidated level based on the geographical diversification of their credit exposures stemming from their international business (the so-called institution-specific CCyB rate). Institutions have one year from an authority's announcement of an increase in the CCyB rate to comply with the requirement. CCyB rate reductions are effective immediately.

27 This appears to be because the regulation governing this tool does not include any contingency wherefore the requirement can be set at 0% or even below the level decided each year by the FSB upon a proposal from the BCBS.

Table 1
NATIONAL COUNTERCYCLICAL CAPITAL BUFFER MEASURES

Country	CCyB (%)			Announcement date (2020)	Responsible authority
	Effective in March 2020	Latest announcement pre-COVID-19	Announced after COVID-19		
DE Germany	0.00	0.25	0.00	18 March	German Financial Stability Committee
				31 March	BaFin
BE Belgium	0.00	0.50	0.00	11 March	Nationale Bank van België/Banque Nationale de Belgique
BG Bulgaria	0.50	1.50	0.50	19 March	Българска народна банка (Bulgarian National Bank)
DK Denmark	1.00	2.00	0.00	12 March	Government
SK Slovakia	1.50	2.00	1.50	28 April	Národná banka Slovenska
			1.00	14 July	
FR France	0.25	0.50	0.00	18 March	French High Council for Financial Stability (HCSF)
IE Ireland	1.00	1.00	0.00	18 March	Central Bank of Ireland
IS Iceland	2.00	2.00	0.00	18 March	Central Bank of Iceland
LT Lithuania	1.00	1.00	0.00	18 March	Lietuvos bankas
NO Norway	1.00	2.50	1.00	13 March	Norges Bank
				13 March	Government
UK United Kingdom	1.00	2.00	0.00	11 March	Bank of England (FPC)
CZ Czech Republic	1.75	2.00	1.75	19 March	Česká národní banka
			0.50	18 June	
SE Sweden	2.50	2.50	0.00	13-16 March	Finansinspektionen
CH Switzerland	2.00	2.00	0,00	25 March	Swiss National Bank
				27 March	Government
HK Hong Kong	2.00	2.00	1.00	16 March	Hong Kong Monetary Authority

SOURCE: Devised by authors (drawing on public information available as of 15 July 2020).
NOTE: The third column refers to the last CCyB rate announced prior to the spread of COVID-19, which would have become effective 12 months after the announcement. Releasing the CCyB is effective immediately. The countries in the table that have not changed the CCyB rate after COVID-19 appear without a figure in the columns for this tool. This table does not include the European countries that have not made any changes to macroprudential tools because of COVID-19.

capital buffers. The calibration of these buffers, consistent with the minimum levels established in the prevailing legislation and the ECB guidance, has not afforded the Banco de España any leeway to reduce them.

The general absence of macroprudential measures relating to limits on and conditions for lending (LTV, LTI, DTI and DSTI limits) is noteworthy. Except for Portugal – which has adopted a measure to prevent lending to households from being limited owing to temporary reductions in their income – a possible explanation could be that COVID-19 has clearly encouraged banks to implement more prudent lending standards and, in general, pay closer scrutiny to borrowers, in which case the existence of minimum regulatory limits becomes less important as it does not entail effective restrictions on lending by institutions.

Table 2
OTHER NATIONAL MACROPRUDENTIAL MEASURES

Country		Announcement date (2020)	Authority	Description
CY	Cyprus	10 April	Central Bank of Cyprus	Deferral by one year (to 2023) of the end of the phase-in period for the O-SII buffers
SI	Slovenia	8 April	Banka Slovenije	Temporary restriction on the distribution of profits by credit institutions
		22 May	Banka Slovenije	Amendment to DSTI ratio limits for households affected by COVID-19
EE	Estonia	25 March	Eesti Pank	Full reduction of the SyRB
FI	Finland	18 March	Finanssivalvonta (FIN-FSA)	Full reduction of the SyRB and selective reduction of the O-SII buffers
HU	Hungary	1 April	Magyar Nemzeti Bank	Full reduction of the O-SII buffers
NL	The Netherlands	17 March	De Nederlandsche Bank	Partial and selective reduction of the SyRB and of the O-SII buffers
				Deferral of the introduction of minimum floors for for mortgage loan risk weighting calculated for institutions using internal models (measure under Article 458 of the CRR)
PL	Poland	16 March	Polish Financial Stability Committee (KSF)	Full reduction of the SyRB (from 3% to 0%)
		20 March	Government	
PT	Portugal	25 March	Banco de Portugal	Amendment to a recommendation applicable to banks on credit limits and standards to exempt certain loans granted to households
		8 May	Banco de Portugal	Postponement by one year (to 2022) of the end of the O-SII buffer phase-in period
CA	Canada	13 March	Office of the Superintendent of Financial Institutions (OSFI)	Reduction (from 2.25% to 1%) of the domestic stability buffer (applicable to domestic systemically important banks)

SOURCE: Devised by authors (drawing on public information available as of 25 June 2020).
NOTE: CCyB and SyRB refer to the countercyclical capital buffer and the systemic risk buffer, respectively. O-SIIs are other systemically important institutions. The third column refers to the last CCyB rate announced prior to the spread of COVID-19, which would have become effective 12 months after the announcement. Releasing the CCyB is effective immediately. The countries in the table that have not changed the CCyB rate after COVID-19 appear without a figure in the columns for this tool. This table does not include the European countries that have not made any changes to macroprudential tools because of COVID-19.

In tandem with the announcements of these national measures, various EU and global bodies issued statements in March urging the national authorities to provide a coordinated macroprudential response. The proposed response was to ease requirements – thereby complementing other microprudential supervisory initiatives – primarily to allow for continued lending by banks to the real economy despite the difficulties associated with COVID-19. The FSB and the BCBS highlighted the flexibility built into macroprudential regulation and encouraged national authorities to make use of it when adopting measures. In the EU, both the EBA and the ECB called on authorities to reduce the CCyB. In April, once most national measures had been adopted, the ECB publicly endorsed them and highlighted its contribution to the measures. As the microprudential supervisory authority with the power to tighten macroprudential measures in the euro area, the ECB issued a nonobjection decision on the proposed CCyB or other macroprudential buffer-related measures that were mandatorily notified by the national authorities. Along the same lines, and one week earlier, the Eurogroup issued its own statement endorsing the measures taken hitherto to shore up financial stability. In mid-June, as part of its Annual Report 2019 on the banking union, the European Parliament passed a resolution that also supported the national measures taken.

The table A.1 in the annex summarises the main statements issued globally and by the EU containing macroprudential policy guidance. ECB Banking Supervision and the EBA issued statements on 12 March, just one day after the WHO declared the pandemic. The BCBS and the FSB did so a week later (20 March).

The European Systemic Risk Board (ESRB) drastically realigned its work programme to focus – during April and May – on five priority areas concerning mainly macroprudential analysis (see the annex). Having moved into "crisis mode", the ESRB's work resulted in, inter alia:

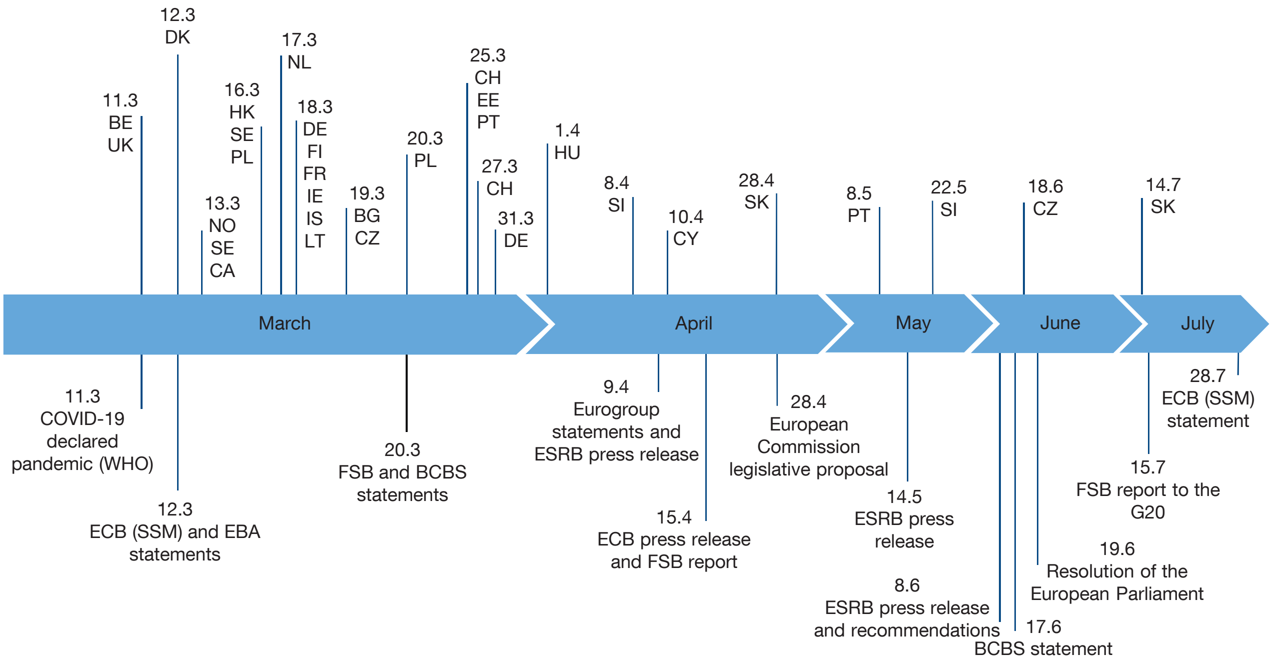
i) a Recommendation for all EU macroprudential authorities on monitoring the financial stability implications of debt moratoria, and public guarantee schemes and other measures of a fiscal nature taken to protect the real economy in response to the COVID-19 pandemic;

ii) a Recommendation for competent microprudential authorities to request that banks, insurance companies, investment firms and central counterparties (CCPs) refrain from making dividend distributions at least until 1 January 2021. This recommendation in turn led the ECB and the SSM national competent authorities to revise their dividend distribution policy at the end of July; and

iii) a Recommendation for competent microprudential authorities, the ESMA and the European Commission on liquidity risks arising from margin calls, with the aim of: i) limiting cliff effects in relation to the demand for collateral; ii) improving stress scenarios for the assessment of CCPs; iii) limiting liquidity constraints related to margin collection; and iv) promoting international standards on mitigating procyclicality in the provision of client clearing services and in securities financing transactions.

Figure 2 includes a timeline of the national macroprudential measures and statements by supranational bodies containing macroprudential policy guidance. Most of the measures, in particular those concerning the CCyB, were taken in the second and third weeks of March. As a result of the commonly followed regulatory timetables, the quarterly review of the CCyB means that at normal times the

Figure 2
TIMELINE OF MACROPRUDENTIAL ACTION (2020)



SOURCE: Devised by authors (drawing on public information).

CCyB rates applicable in the second quarter of the year (or, if the rate is increased, the second quarter of the following year) are announced during the second half of March. This circumstance, combined with the immediacy of the rates' entry into force, partly explains the authorities' swift reaction to the events of the first weeks of March. By contrast, extraordinary macroprudential measures concerning other tools were adopted in the following weeks (although some of them are not in fact effective until 1 January 2021).

The speed of the national macroprudential authorities' reaction was presumably affected by a wide range of factors. On the one hand, domestic epidemiological developments and those in neighbouring countries could have influenced the diagnosis of the severity of the situation and the resulting greater or lesser urgency to take measures swiftly. On the other, the characteristics of the domestic institutional frameworks could also have played their part. Depending on the country, one or more authorities participate in the adoption of measures concerning macroprudential tools subject to flexible governance arrangements (in some countries an authority adopts macroprudential measures upon a proposal from another authority or an interagency committee). Furthermore, in the euro area national macroprudential authorities' obligation to inform the ECB of their proposed measures in advance could also have delayed the announcement of some measures in certain cases.

4 Measures aimed at easing the operational burden: reprioritising resources without undermining financial stability and fostering international coordination

The authorities have introduced a series of adjustments to alleviate the operational burden in order to focus resources on financial stability priorities and the response to COVID-19. COVID-19 has had a widespread impact, affecting not only the financial markets and the real economy but also society as a whole. The social distancing and confinement measures have been applied globally in various jurisdictions with operational capacity consequences for both supervisory authorities and banks, making the adoption of these measures necessary.

Some examples of these adjustments at the international level include international organisations (such as the FSB and the BCBS) reprioritising their work plans to focus efforts on coordinating the response to the crisis. The BCBS postponed all assessment exercises related to the implementation of standards under its Regulatory Consistency Assessment Programme (RCAP) to 2021. At the same time, the BCBS reviewed and reduced the non-essential information for designating global sistemically important banks (G-SIBs) and decided to postpone the implementation of the 2019 revised G-SIB framework by one year, from 2021 to 2022.[28]

The deferral of Basel III implementation is also noteworthy. The Group of Central Bank Governors and Heads of Supervision (GHOS), as the body overseeing the decisions adopted by the BCBS, decided to defer by one year to 2023 the implementation of the Basel III standards finalised in 2017,[29] the market risk framework finalised in 2019 and the Pillar 3 disclosure requirements finalised in December 2018.[30]

The objective of this set of reforms is to complement the Basel III standards adopted in 2011, lessen the excessive volatility of risk-weighted assets (the capital ratio's denominator) and adapt the disclosure standards accordingly. They are a key part of the new regulatory framework arranged internationally in the wake of the crisis. The objective of revising the deadlines to delay implementation by one year is to afford the banking sector and the authorities greater capacity to respond to the short-term impact of COVID-19. By no means is the delay meant to bring into question the essence of these changes or their implementation; in this connection GHOS members unanimously reaffirmed their expectation of full, timely and consistent implementation of all Basel III standards based on this revised timeline. Indeed,

28 Basel Committee on Banking Supervision (2018). The revised framework included a series of enhancements such as the introduction of a trading volume indicator and the extension of the scope of consolidation to insurance subsidiaries.

29 For further details on these measures see Anguren, Castro and Durán (2018).

30 Along the same lines and in order to alleviate the operational burden, the BCBS and IOSCO agreed to extend by one year the deadline for completing the final two implementation phases of the margin requirements for non-centrally cleared derivatives.

current events demonstrate once again the importance of a resilient financial system, which these reforms will help further reinforce.

The European Commission joined the BCBS' initiative and announced the deferral by one year of implementation of Basel III in the EU, while the EBA has postponed its stress test to 2021. To facilitate banks focusing on core banking operational matters, the EBA decided to postpone the 2020 stress test, replacing it with a transparency exercise, which is less resource-intensive for institutions. It also asked the supervisors to give banks leeway in the remittance dates for some areas of supervisory reporting that were not essential to monitoring the crisis and, in general, to postpone non-essential information requests.

5 Conclusion: initial lessons and future considerations

The coordinated response by the authorities, both globally and between authorities entrusted with different regulatory areas, is key. The ramifications of the impact of COVID-19 span sectors and different geographical areas owing to its nature and the existing interconnections in an increasingly globalised world. Against this background, the role of supranational bodies is of the utmost importance.

Turning to the banking sector, the crisis triggered by the pandemic has shown once again the importance of having robust regulation in place at the international level that ensures institutions' capital and liquidity positions. In this connection, the Basel III reform has proven to be a fundamental tool in helping absorb the shock triggered by COVID-19 and shows the importance of jurisdictions fulfilling their commitment to full, timely and consistent implementation of the outstanding reforms.

On the accounting front, the IFRS framework, including the expected credit loss approach for estimating provisions, has proven to be flexible enough to adapt to the situation triggered by COVID-19, enabling supervisors and regulators to provide institutions with guidance on applying the accounting rules under IFRS in order to mitigate the procyclicality of inadequate practices.

Furthermore, the vast experience gained since the outbreak of the COVID-19 crisis will also provide important lessons for macroprudential policy conduct. COVID-19 has been a huge non-cyclical and exogenous shock to the financial system, for which no macroprudential tool was theoretically designed. The countercyclical capital buffer (CCyB) has taken on particular importance in the current setting since it is designed to be released when the credit cycle contracts. However, the CCyB was not a uniformly enforceable requirement pre-crisis and, therefore, its release was only an option for the national macroprudential authorities that had previously set it at a positive rate.

The CCyB operationalisation paradigm bears reflecting upon. Up until the beginning of this year, some authorities had activated the CCyB due to the presence of signs of imbalance in their credit cycles or, alternatively, due to merely precautionary reasons ahead of possible adverse future shocks, taking advantage of the discretionality built into the regulation governing this instrument for shoring up institutions' solvency. The outbreak of COVID-19 has highlighted the benefits of this second approach – based on setting a minimum positive CCyB that can be revised due to cyclical considerations – to cope with unexpected distress exogenous to the financial system. Such a change in the use of the CCyB could be part of a more extensive review of the weight the releasable macroprudential buffers (the CCyB and the systemic risk buffer) should have relative to the structural institution–specific buffers (the G-SII, O-SII and capital conservation buffers). The response to the crisis would have been more effective and flexible had the former's weight relative to the latter's been greater.

Planning the future path of rebuilding the capital buffers as the economic recovery takes hold is another matter that should feature on the prudential authorities' agenda. This issue was highlighted by the BCBS in its 17 June statement, by some Bank for International Settlements officials [Bank for International Settlements (2020)] and by the ECB. Some national authorities [De Nederlandsche Bank (2020)] have publicly presaged, by means of forward guidance, their intention to set a positive CCyB rate to the detriment of structural buffers, with the ultimate aim of affording themselves greater scope for action in response to future crisis episodes. More immediately, the Banco de España has conveyed its intention to hold at 0% the CCyB for a prolonged period, at least until the main economic and financial effects arising from the coronavirus crisis have dissipated [Banco de España (2020e)].

The supervisory and regulatory authorities must remain vigilant in the highly uncertain environment caused by COVID-19 in order to ensure the financial system's resilience. A key area of focus in the future will be strategies for withdrawing the temporary measures adopted. In this regard, the international bodies and national authorities must reflect on and analyse the design of exit strategies that, given the existing uncertainty, must take into account the possible cliff effects they might cause and the potential trade-offs, such as an excessively premature withdrawal that jeopardises the possible recovery.

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Table A.1
STATEMENTS BY SUPRANATIONAL BODIES CONTAINING MACROPRUDENTIAL GUIDANCE

Body	Date (2020)	Statements containing macroprudential guidance
European Central Bank (ECB), Single Supervisory Mechanism (SSM)	12 March	ECB Banking Supervision provides temporary capital and operational relief in reaction to coronavirus "The ECB considers that these temporary measures will be enhanced by the appropriate relaxation of the countercyclical capital buffer (CCyB) by the national macroprudential authorities"
	28 July	ECB extends recommendation not to pay dividends until January 2021 and clarifies timeline to restore buffers
European Banking Authority (EBA)	12 March	EBA statement on actions to mitigate the impact of COVID-19 on the European Union banking sector "A number of provisions in the regulatory framework ensure that banks build up adequate capital and liquidity buffers. These buffers, including macroprudential ones, are designed to be used in order to absorb losses and ensure continued lending to the economy during a downturn. Banks should also follow prudent dividend and other distribution policies, including variable remuneration. [...] The EBA is in close contact with the European Systemic Risk Board in order to ensure that microprudential and macroprudential measures are fully aligned"
Basel Committee on Banking Supervision (BCBS)	20 March	Basel Committee coordinates policy and supervisory response to COVID-19 "The Basel III framework includes capital and liquidity buffers that are designed to be used in periods of stress. These include the capital conservation buffer and, by extension, the countercyclical capital buffer and buffers for systemically important banks. [...] Many supervisors are already encouraging banks to make use of these tools, which allow for flexibility in responding to the current circumstances"
	17 June	Basel Committee meets; discusses impact of COVID-19; reiterates guidance on buffers "The measures taken by the Committee at the onset of the pandemic have helped mitigate some of the short-term financial stability risks. […] The Committee views a measured drawdown of banks' Basel III buffers to meet these objectives as both anticipated and appropriate in the current period of stress. Supervisors will provide banks sufficient time to restore buffers taking account of economic and market conditions and individual bank circumstances"
Financial Stability Board (FSB)	20 March	FSB coordinates financial sector work to buttress the economy in response to COVID-19 "The FSB encourages authorities and financial institutions to make use of the flexibility within existing international standards to provide continued access to funding for market participants and for businesses and households facing temporary difficulties from COVID-19, and to ensure that capital and liquidity resources in the financial system are available where they are needed. Many members of the FSB have already taken action to release available capital and liquidity buffers"
	15 April	COVID-19 pandemic: Financial stability implications and policy measures taken "The official sector community is providing a rapid and coordinated response to support the real economy, maintain financial stability and minimise the risk of market fragmentation. This response is underpinned by the following principles: [...] 2. Authorities recognise, and will make use of, the flexibility built into existing financial standards – including through the use of firm-specific and macroprudential buffers – to sustain the supply of financing to the real economy, to support market functioning and to accommodate robust business continuity planning"
	15 July	FSB Chair letter to G20 Finance Ministers and Central Bank Governors "Using flexibility in standards and buffer use. Most measures taken by FSB members have used the flexibility built into international standards, including regarding the use of capital and liquidity buffers. [...] Supervisors have agreed that banks will be given sufficient time to restore buffers, taking account of economic and market conditions and individual bank circumstances"

Table A.1
STATEMENTS BY SUPRANATIONAL BODIES CONTAINING MACROPRUDENTIAL GUIDANCE (cont.)

Body	Date (2020)	Statements containing macroprudential guidance
European Central Bank (ECB)	15 April	ECB supports macroprudential policy actions taken in response to coronavirus outbreak “ECB supports the swift action taken by euro area macroprudential authorities to address the financial sector impact of the coronavirus outbreak by releasing or reducing capital buffers. […] They include releases or reductions of the countercyclical capital buffer, systemic risk buffer and buffers for other systemically important institutions. In addition, some authorities have postponed or revoked earlier announced measures to avoid placing pressure on banks to accumulate capital buffers in a downturn”
European Systemic Risk Board (ESRB)	9 April	The General Board of the ESRB held its 37th regular meeting on 2 April 2020 “Against this background [COVID-19] the General Board underlined that a timely and coordinated policy response is key, in particular to achieve important synergies between fiscal, monetary and regulatory policies. To this end, the General Board decided to focus its attention on five priority areas, specifically: – implications for the financial system of guarantee schemes and other fiscal measures to protect the real economy; – market illiquidity and implications for asset managers and insurers; – impact of procyclical downgrades of bonds on markets and entities across the financial system; – system-wide restraints on dividend payments, share buybacks and other payouts; – liquidity risks arising from margin calls”
	14 May	The General Board of the ESRB takes first set of actions to address the coronavirus emergency at its extraordinary meeting on 6 May 2020
	8 June	The General Board of the ESRB takes second set of actions in response to the coronavirus emergency at its extraordinary meeting on 27 May 2020
Eurogroup	9 April	Report on the comprehensive economic policy response to the COVID-19 pandemic “Financial Stability: We welcome the guidance provided by supervisory authorities to financial institutions on the interpretation and application of the regulatory requirements in the current exceptional circumstances. We also welcome the release of capital buffers. To overcome the financing pressures faced by firms and households, making full use of the flexibility provided for in the regulatory framework is essential”
European Commission	28 April	Coronavirus Response: Commission adopts banking package to facilitate lending to households and businesses in the EU “The Commission encourages the ESRB to coordinate an EU-wide approach as regards the use of macroprudential buffers in the crisis and recovery phase”
European Parliament	19 June	European Parliament Resolution of 19 June 2020 on Banking Union – Annual Report 2019 “General considerations: […] 10. Emphasises that the provision of credit and liquidity by banks plays a decisive role in mitigating the most severe economic consequences of the COVID-19 outbreak on people in the EU; notes, in this context, the legislative and supervisory measures that have been proposed or adopted to make sure that banks keep lending throughout this crisis; welcomes [...] the release of capital buffers”

SOURCE: Devised by authors (drawing on public information).
NOTE: This table does not include references to speeches by officials of these institutions or to regular publications (such as financial stability reports).