Box 2.2

RELAXING APPLICATION OF PRUDENTIAL REGULATIONS AND ACCOUNTING STANDARDS. ECB AND BANCO DE ESPAÑA MEASURES

In response to the extraordinary situation prompted by the pandemic, the authorities swiftly adopted a raft of monetary, fiscal and financial policy measures aimed at mitigating the impact of the crisis.

The initial supervisory measures focused on easing capital and liquidity requirements and lightening certain operational burdens imposed by supervision.

The easing of capital and liquidity requirements has allowed institutions to temporarily operate below the levels set for their Pillar 2 Guidance (P2G), capital conservation buffer and liquidity coverage ratio (LCR).

The supervisor expects institutions to replenish LCR levels by end-2021 at the earliest and P2G levels a year later (no sooner than end-2022), although those dates may be put back depending on the economic situation and each institution's particular position, with a view to heading off procyclical effects.

Furthermore, the change in the composition of P2R, originally envisaged in the Capital Requirements Directive V for January 2021, was brought forward to March 2020: P2R should have the same capital composition as that of Pillar 1, meaning at least 56.25% of P2R should be held in common equity Tier 1 capital (CET1) and 75% in Tier 1 capital, instead of 100% in CET1 as established hitherto.

To complement these capital measures, the macroprudential authorities eased the countercyclical capital buffer in those Single Supervisory Mechanism countries where it was activated or scheduled to be activated over 2020-2021.

In addition, it is worth mentioning that both the Banco de España and the European Central Bank (ECB) announced greater supervisory flexibility in the prudential treatment of loans backed by State guarantees.

Furthermore, in line with statements made by international regulators and supervisors, the Banco de España and the ECB also encouraged institutions to make use of the flexibility afforded by International Financial Reporting Standard 9. Specifically, they indicated that measures such as moratoria and State guarantees should not automatically mean worse credit risk classifications for exposures. This would afford institutions greater scope to discriminate between viable and non-viable credit transactions. Likewise, they were reminded that the remaining lifetime of a loan should be considered when determining whether there has been a significant increase in credit risk (entailing a deterioration of their accounting classification).

Broadly speaking, these measures are geared towards forestalling the potential procyclical effects of capital and liquidity requirements, and the application of the accounting framework, such that the institutions remain unfettered in their capacity to lend to the overall economy, at a time when this is an essential function to mitigate the impact of the crisis[1].

1 For a more extensive summary of the prudential and accounting regulation flexibility measures, see R. Anguren, L. Gutiérrez de Rozas, E. Palomeque and C.J. Rodríguez García (2020), "The regulatory and supervisory response to the COVID-19 crisis", *Financial Stability Review,* No 39, Autumn, Banco de España.