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Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards adjustments in
response to the COVID-19 pandemic

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

• **Reasons for and objectives of the proposal**

Regulation (EU) No 575/2013¹ of the European Parliament and of the Council (the Capital Requirements Regulation or CRR) establishes together with Directive 2013/36/EU² (the Capital Requirements Directive or CRD) the prudential regulatory framework for credit institutions operating in the Union. The CRR and CRD were adopted in the aftermath of the 2008-2009 financial crisis to enhance the resilience of institutions operating in the EU financial sector, largely based on global standards agreed with the EU's international partners, in particular the Basel Committee on Banking Supervision (BCBS).

The CRR has been subsequently amended to tackle remaining weaknesses in the prudential regulatory framework and to implement some outstanding elements of the global financial services reform that are essential to ensure institutions' resilience. Amongst various subsequent changes, Regulation (EU) 2017/2395³ has inserted in the CRR transitional arrangements for mitigating the impact on own funds from the introduction of the new accounting standard, the International Financial Reporting Standard – Financial Instruments (IFRS) 9. Regulation (EU) 2019/630⁴ has introduced in the CRR a requirement for minimum loss coverage for non-performing exposures (the so-called prudential backstop). Furthermore, Regulation (EU) 2019/876⁵ (CRR II) has added to the CRR some of the final elements of the international reforms (the finalised Basel III framework), which entail amongst others, a new definition of the leverage ratio and a leverage ratio buffer, which will prevent institutions from excessively increasing leverage. The latter Regulation has also introduced in the CRR more favourable prudential treatments of certain software assets, of certain pension- and salary-backed loans, as well as of loans to small and medium sized enterprises (SMEs) and infrastructure projects.

¹ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions.

² Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

³ Regulation (EU) 2017/2395 of the European Parliament and of the Council of 12 December 2017 amending Regulation (EU) No 575/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds and for the large exposures treatment of certain public sector exposures denominated in the domestic currency of any Member State (OJ L 345, 27.12.2017, p. 27).

⁴ Regulation (EU) 2019/630 of the European Parliament and of the Council of 17 April 2019 amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures (OJ L 111, 25.4.2019, p. 4).

⁵ Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 (OJ L 150, 7.6.2019, p. 1).

The severe economic shock caused by the COVID-19 pandemic and the exceptional containment measures are having a far-reaching impact on the economy. Businesses are facing disruption in supply chains, temporary closures and reduced demand, while households are confronted with unemployment and a fall in income. Public authorities at Union and Member State levels have taken decisive actions to support households and solvent undertakings to withstand this severe but temporary slowdown in economic activity and the liquidity shortages that it will cause. Due to the reforms undertaken in the aftermath of the 2008 financial crisis, credit institutions are today well capitalised and much more resilient than they were in 2008. This enables them to play a key role in managing the economic shock that stems from the COVID-19 pandemic. Nevertheless, uncertainty related to the pace of recovery of economic activity will inevitably have an impact on the banking sector.

In reaction to the new circumstances, competent authorities across the Union have provided temporary capital and operational relief to ensure favourable conditions for credit institutions to continue lending amid COVID-19. It is therefore important that capital is deployed where it is most needed and that the prudential framework interacts smoothly with the various measures that address the COVID-19 pandemic. The CRR offers ample leeway for banks to support public and private initiatives to promote continued lending in the context of the COVID-19 pandemic, while ensuring a prudent approach. The flexibility embedded in the CRR is described in the Commission Interpretative Communication of 28 April 2020⁶ on the application of the accounting and prudential frameworks to facilitate bank lending in the Union amid COVID-19.

Besides making full use of the flexibility allowed for in the existing framework, some limited changes to specific aspects of the CRR are necessary in order to maximise the capacity of credit institutions to lend and to absorb losses related to the COVID-19 pandemic, while still ensuring their continued resilience. Moreover, at international level, the BCBS has agreed a one-year delay in the deadline for implementing the final elements of the Basel III framework, of which some elements had been already incorporated in the CRR⁷, as well as a greater flexibility to the phase-in of the impact of the IFRS 9 on capital. These changes need to be reflected in the existing rules.

First, it is necessary to adjust the transitional arrangements that allow credit institutions to alleviate the impact from expected credit-loss (ECL) provisioning under IFRS 9 on their own funds. This adjustment would allow credit institutions to better mitigate the impact of any potential increase in ECL provisioning caused by the deterioration in the credit quality of credit institutions' exposures due to the economic consequences of the COVID-19 pandemic.

Second, to account for the impact of COVID-19 related guarantees, the rules on the minimum loss coverage for non-performing exposures (NPEs) need to be adjusted to extend temporarily the treatment that is currently applicable to NPEs guaranteed or insured by export credit agencies to NPEs that would arise as a consequence of the COVID-19 pandemic and that are covered by the various guarantee schemes that were put in place by Member States. This would recognise the similar characteristics shared by export credit agencies guarantees and COVID-19 related guarantees.

⁶ Communication from the Commission to the European Parliament and the Council - Commission Interpretative Communication on the application of the accounting and prudential frameworks to facilitate EU bank lending - Supporting businesses and households amid COVID-19, COM(2020)169 of 28.04.2020.

⁷ The postponement covers both, the revised rules on risk-based capital requirements and the revised rules on the leverage ratio.

Third, the offsetting mechanism associated with the competent authority discretion to allow credit institutions to temporarily exclude exposures in the form of central bank reserves from the calculation of the leverage ratio needs to be modified. This would ensure that liquidity measures provided by central banks in a crisis context would be effectively channelled by credit institutions to the economy.

Fourth, it is necessary to defer, in line with the decision of the BCBS, the application date of the new leverage ratio buffer requirement. This would free up credit institutions' operational capacity and allow them to focus on the more immediate challenges associated with the COVID-19 pandemic.

Fifth, the application dates of some of the capital benefits envisaged in the CRR but not yet applicable need to be anticipated, namely the provisions on the treatment of certain software assets, the provisions on certain loans backed by pensions or salaries, the revised supporting factor for small and medium-sized enterprises (SME) and the new supporting factor for infrastructure finance. Advancing the date of application of the two supporting factors, the preferential treatment of certain software assets, and the preferential treatment of certain loans backed by pensions or salaries would free up own funds of institutions, allowing them to boost much needed lending during the COVID-19 pandemic and its aftermath.

These proposed changes will not fundamentally alter the prudential regulatory framework. They form part of the response of the Commission to address the emergency situation triggered by the COVID-19 pandemic. These adjustments to the prudential framework would facilitate collective efforts aimed at mitigating the impact of the pandemic and thus moving towards a fast recovery.

- **Consistency with existing policy provisions in the policy area**

The proposal introduces amendments to existing legislation. These amendments are fully consistent with the existing policy provisions in the field of prudential requirements for institutions and their supervision, including with the Commission's Interpretative Communication adopted at the same time as this proposal. They are also fully consistent with the Union's accounting rules, in particular with Commission Regulation (EU) 2016/2067 of 22 November 2016 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards IFRS 9. This proposal complements measures taken by the European Central Bank, the European Banking Authority and national competent authorities in this area.

- **Consistency with other Union policies**

This proposal is part of the broader response by the European Commission to the COVID-19 pandemic. It is instrumental to ensuring the effectiveness of measures adopted by the Member States, the Commission and the European Central Bank. It is fully consistent with the Commission Communication on the economic aspects of the coronavirus crisis issued on 13 March 2020⁸, as well as with 'COVID 19 – Economic package – Using every available Euro' launched on 2 April 2020⁹.

⁸ Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Investment Bank and the Eurogroup on Coordinated economic response to the COVID-19 Outbreak, COM(2020) 112 final of 13.03.2020.

⁹ Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions on Coronavirus Response - Using every available euro in every way possible to protect lives and livelihoods, COM(2020) 143 final of 02.04.2020.

2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY

- **Legal basis**

The proposal is based on Article 114 of the Treaty on the Functioning of the European Union (TFEU), the same legal basis as for the legislative acts that are being amended.

- **Subsidiarity (for non-exclusive competence)**

The objectives pursued by the envisaged amendments, namely to maximise the capacity of credit institutions to lend and to absorb losses related to the COVID-19 pandemic, while still ensuring their continued resilience, can be better achieved at Union level rather than by different national initiatives as the amendments concern the application dates of Union rules or represent adjustments to existing Union rules in response to the COVID-19 pandemic. The problems and the underlying causes are the same across all Member States. In the absence of action by the Union the existing regulatory framework would be less effective in supporting the various measures taken by public authorities at both Union and national level and less reactive to exceptional market challenges.

The ability of Member States to adopt national measures is limited, given that the CRR already regulates those matters, and changes at national level would conflict with Union law currently in force. If the Union were to cease regulating those aspects, the internal market for banking services would become subject to different sets of rules, leading to fragmentation and undermining the recently build single rulebook in this area.

- **Proportionality**

This Union action is necessary to achieve the objective of maximising credit institutions' capacity to lend and to absorb losses amid the COVID-19 pandemic, whilst maintaining the consistency of the prudential framework. The proposed amendments do not go beyond addressing selected provisions in the Union's prudential framework for credit institutions that target exclusively measures aimed at ensuring recovery from the current COVID-19 pandemic. Moreover, the proposed amendments are limited to those issues which cannot be addressed within the existing margin of discretion the current rules provide for.

3. RESULTS OF EX-POST EVALUATIONS, STAKEHOLDER CONSULTATIONS AND IMPACT ASSESSMENTS

This proposal is not accompanied by a separate impact assessment, as this proposal does not alter the fundamental aspects of the CRR and does not impose new obligations on the concerned parties. Moreover, the impact of the measures which are being amended by this proposal have been subject to analysis in the impact assessments undertaken for Regulation (EU) 2017/2395, Regulation (EU) 2019/876 and Regulation (EU) 2019/630 amending the CRR in relation to aspects covered by this proposal.. The proposal primarily aims at providing, for exceptional reasons in the context of the current COVID-19 pandemic, deferrals as regards the date of application of certain provisions of the CRR, or anticipating the application of measures that would relieve banks from some capital requirements, or specifying the prudential treatment of certain exposures in light of the exceptional circumstances created by the COVID-19 pandemic.

The proposed amendments would have a limited impact on the administrative burden for banks and the costs for them to adapt their internal operations, with costs expected to be offset by benefits derived in terms of capital availability. The proposed amendments concern

provisions that enable banks to use more favourable treatments, but do not impose on them such treatments.

- **Fundamental rights**

The Union is committed to high standards of protection of fundamental rights and is signatory to a broad set of conventions on human rights. In this context, the proposal is not likely to have a direct impact on these rights, as listed in the main UN conventions on human rights, the Charter of Fundamental Rights of the European Union, which is an integral part of the EU Treaties and the European Convention on Human Rights (ECHR).

4. BUDGETARY IMPLICATIONS

The proposal does not have a budgetary impact for the Union institutions.

5. OTHER ELEMENTS

- **Detailed explanation of the specific provisions of the proposal**

Transitional arrangements for mitigating the impact of IFRS 9 provisions on regulatory capital

Article 473a of the CRR contains transitional arrangements allowing institutions to add back to their Common Equity Tier 1 (CET1) capital a portion of any increase in provisions due to the introduction of ECL accounting under IFRS 9. The transitional arrangements consist of two components: a static and a dynamic component. The static component allows credit institutions to partially neutralise the “day-one impact” on CET1 capital of the increase in accounting provisions due to the introduction of IFRS 9. The dynamic component allows banks to partially neutralise the impact of the additional (i.e. post-day-one) increase in provisions for financial assets that are not credit-impaired. The existing transitional arrangements cover the period 2018-2022.

The application of IFRS 9 during the economic downturn caused by the COVID-19 pandemic may lead to a sudden significant increase in ECL provisions, as for many exposures expected losses over their lifetime may need to be calculated. To mitigate the potential impact that a sudden increase in ECL provision may have on institutions’ capacity to lend to clients at times when it is most needed, the transitional arrangements should be extended. This would bring additional relief to the impact of the COVID-19 pandemic on institutions’ possible rise in provisioning needs under IFRS 9, while maintaining the transitional arrangements for the ECL amounts established before the COVID-19 pandemic. Therefore, these amendments would allow resetting the 5-year transition period which started in 2018. The new transition period will thus allow financial institutions to adjust the calibration of the arrangements for adding back provisions to CET1 capital during the period 2020-2024.

In the context of the COVID-19 pandemic the transitional arrangements are extended only for the dynamic component in accordance with the targeted revisions¹⁰ of the internationally agreed prudential standards (Article 1 point (2) of the proposal) to address the potential increase in ECL provisions following the COVID-19 pandemic. To ensure that the additional relief is targeted at ECL arising from the exceptional circumstances of the COVID-19 pandemic without introducing undue complexity, the reference date for any increase in

¹⁰ See press release “Basel Committee sets out additional measures to alleviate the impact of Covid-19”, 3 April 2020, available at: <https://www.bis.org/press/p200403.htm>.

provisions that would be subject to the extended transitional arrangements is moved from 1 January 2018 to 1 January 2020, as from this date on additional losses incurred by institutions would likely be related to the COVID-19 pandemic.

Article 473a(1) of the CRR contains a revised formula for the calculation of the ECL amounts that can be included in (i.e. “added back to”) CET1 capital, which applies different factors to the static and the dynamic component, respectively. While the calculation of the static component remains unchanged following this proposal, the dynamic component will be subject to an extended transitional period and to a revised transitional adjustment factor.

The reference dates in paragraphs (3) and (5) of Article 473a of the CRR for computing a possible increase in ECL provisions for non-credit-impaired assets at the reporting date, which may be added back to CET1 capital are amended in consideration of the revised formula in paragraph 1 and the new cut-off date.

The transition period for the static component in Article 473a(6) of the CRR is adapted in light of the new formula in paragraph 1 of that Article.

A new paragraph 6a extends the transition for the dynamic component, allowing institutions to fully add-back to their CET1 capital any increase in new provisions recognised in 2020 and 2021 for their financial assets that are not credit-impaired. The amount that could be added back from 2022 to 2024 would decrease in a linear manner.

Changes to Article 473a(7) of the CRR simplify the recalculation of capital requirements. They replace the rescaling of all exposure values that are reduced by provisions with a standard risk weight of 100% to be assigned to the amounts added back to CET1 capital.

Changes to Article 473a(9) of the CRR allow institutions that opted previously not to use the transitional arrangements to reverse that decision anytime during the transitional period subject to prior approval from their competent authority. Furthermore, Article 473a(9) of the CRR provides institutions with the option to apply only the dynamic component. Finally, to monitor the number of institutions across the EU using the transitional arrangements, competent authorities are required to periodically submit information on the number of institutions they supervise that use those arrangements to the EBA.

Treatment of publicly guaranteed loans under the NPL prudential backstop

Official export credit agencies typically issue guarantees on behalf of national governments to provide credit protection for loans that are extended for export financing purposes. Non-performing loans guaranteed by such agencies receive a preferential treatment regarding provisioning requirements under Article 47c of the CRR. The proposed derogation from Article 47c(3) extends this preferential treatment to exposures guaranteed or counter-guaranteed by the public sector in the context of measures aimed at mitigating the economic impact of the COVID-19 pandemic, subject to Union State aid rules, where applicable. This would take account of the similar risk profile of these guaranteed exposures (Article 1 point (3) of the proposal).

Date of application of the leverage ratio buffer

The CRR II introduced in the CRR a new Article 92(1a) imposing a leverage ratio buffer requirement on global systemically important institutions. The date of application of the buffer was originally set to 1 January 2022. In the context of the COVID-19 pandemic and in line with the revised implementation timeline agreed by the BCBS, the date of application set

in Article 3(5) of the CRR II is deferred by one year, to 1 January 2023 (Article 2 point (2) of the proposal).

Offsetting the impact of excluding certain exposures from the calculation of the leverage ratio

The CRR II has modified the calculation of the leverage ratio on the basis of the revised Basel standard. The changes included the implementation of a discretion to temporarily exclude certain central bank exposures from an institutions' total exposure measure in exceptional circumstances (Article 429a(1)(n) and (5) to (7) of the CRR). The exemption may be granted for a limited period of time not exceeding one year, where the institution's competent authority has determined, after consulting the relevant central bank, and has declared publicly that such exceptional circumstances exist. Any impact of the exclusion is fully offset via a mechanism set out in Article 429a(7) of the CRR that increases a credit institutions' individual leverage ratio requirement in a strictly proportionate manner.

The discretion, which is intended to facilitate the effective transmission of monetary policy measures, will become applicable together with the leverage ratio requirement on 28 June 2021. However, the current COVID-19 crisis has shown that the offsetting mechanism, when applicable, would be too restrictive and that its application would actually not facilitate an effective transmission of monetary policy. Indeed, because of the current offsetting mechanism, credit institutions may be constrained with regard to the level of the increase of their central bank reserves. The current offsetting mechanism might therefore discourage credit institutions from drawing on central bank liquidity facilities in a situation of stress to the extent that is needed or wished. This would result in hampering the effective transmission of monetary policy measures and, ultimately, forcing an institution to deleverage by selling assets or reducing the level of lending to the real economy, or both, given its limited leeway to control the extent of these reserves during a crisis.

On the basis of these findings, and in light of the Commission's mandate set out in Article 511 of the CRR to review, amongst others, the treatment of central bank reserves, the Commission considers it is appropriate to modify the offsetting mechanism before it becomes applicable (Article 1 point (1)(b) of the proposal). This will enhance the flexibility to act appropriately and purposefully during possible future shocks and crises and enhance the effectiveness of the measure. In particular, a credit institution that exercises the discretion will be required to calculate the adjusted leverage ratio only once, namely at the moment it exercises the discretion, and based on the value of the institution's eligible central bank reserves and total exposure measure on the day when the institution's competent authority declares that exceptional circumstances that warrant the exercise of the discretion exist. The adjusted leverage ratio will apply throughout the full period during which the discretion is exercised and will not change like under the current offsetting mechanism. The modifications to the offsetting mechanism require also changes to Article 429a(1)(n) to allow the exclusion of all eligible central bank reserves rather than just those entered into after the exemption took effect (Article 1 point (1)(a) of the proposal).

Date of application of the exemption of certain software assets from capital deductions

The CRR II introduced provisions to change the regulatory treatment of "prudently valued software assets", which are not materially affected in a gone concern situation (i.e. the

resolution, insolvency or liquidation of an institution). Institutions will not be required anymore to deduct these particular software assets from their Common Equity Tier 1 capital (point (b) of Article 36(1) of the CRR). The EBA was mandated to develop a draft Regulatory Technical Standard (RTS) to specify how this exemption from deductions is to be applied, by defining the scope of software assets to be exempted and how they will be risk-weighted (Article 36(4) of the CRR). The application date of the revised treatment of software assets has been set to 12 months after the entry into force of this RTS (Article 3(7) of the CRR II).

In the context of the accelerated up-take of digital services as a consequences of public measures adopted to address the COVID-19 pandemic, the date of application is amended in order to permit the exemption to apply earlier, namely as of the date of entry into force of the RTS (Article 2 point (3) of the proposal).

Date of application of the specific treatment envisaged for certain loans backed by pensions or salaries

The CRR II introduced in Article 123 of the CRR a more favourable treatment of certain loans granted by credit institutions to pensioners or employees with a permanent contract. This favourable treatment was introduced because of the additional guarantees attached to such loans stemming from the unconditional transfer of part of the borrower's pension or salary to that credit institution. The application of this treatment in the context of the COVID-19 pandemic would incentivise institutions to increase lending to employees and pensioners. To allow institutions to benefit from the more favourable treatment already during the COVID-19 pandemic, the date of application of that provision is advanced (Article 2 point (1) of the proposal).

Date of application of the revised SME supporting factor and the infrastructure supporting factor

The CRR II made changes to Article 501 of Regulation (EU) No 575/2013 concerning the adjustment of own funds requirements for non-defaulted SME exposures (the SME supporting factor), and introduced in Article 501a of Regulation (EU) No 575/2013 a new adjustment to own funds requirements for exposures to entities that operate or finance physical structures or facilities, systems and networks that provide or support essential public services (the infrastructure supporting factor). These supporting factors allow a more favourable treatment of certain exposures to SMEs and infrastructure with a view to incentivise institutions to prudently increase lending to those entities. In the context of the COVID-19 pandemic it is essential that banks continue lending to SMEs and supporting infrastructure investments. Therefore, the date of application of the two supporting factors as set out in Article 3 of CRR II is advanced (Article 2 point (1) of the proposal).

Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

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

(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

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

Having regard to the proposal from the European Commission,

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

Having regard to the opinion of the European Central Bank,

Having regard to the opinion of the European Economic and Social Committee,

Acting in accordance with the ordinary legislative procedure,

Whereas:

- (1) Regulation (EU) No 575/2013 of the European Parliament and of the Council¹¹ establishes, together with Directive of the European Parliament and of the Council 2013/36/EU¹², the prudential regulatory framework for institutions operating in the Union. Adopted in the aftermath of the financial crisis that unfolded in 2007-2008 and largely based on international standards agreed in 2010 by the Basel Committee on Banking Supervision (BCBS), known as the Basel III framework, that prudential framework has contributed to enhancing the resilience of institutions operating in the Union and to making them better prepared to face potential difficulties, including difficulties stemming from possible future crises.
- (2) Since its entry into force, Regulation (EU) No 575/2013 has been amended several times to address remaining weaknesses in the prudential regulatory framework and to implement some outstanding elements of the global financial services reform that are essential to ensure the resilience of institutions. Among the subsequent changes, Regulation (EU) 2017/2395 of the European Parliament and of the Council¹³ has

¹¹ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

¹² Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

¹³ Regulation (EU) 2017/2395 of the European Parliament and of the Council of 12 December 2017 amending Regulation (EU) No 575/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds and for the large exposures treatment of certain public

introduced in Regulation (EU) No 575/2013 transitional arrangements for mitigating the impact on own funds from the introduction of the International Financial Reporting Standard - Financial Instruments (IFRS 9). Regulation (EU) 2019/630 of the European Parliament and of the Council¹⁴ has introduced in Regulation (EU) No 575/2013 a requirement for minimum loss coverage for non-performing exposures, the so-called prudential backstop. Furthermore, Regulation (EU) 2019/876 of the European Parliament and of the Council¹⁵ has introduced to Regulation (EU) No 575/2013 some of the final elements of the finalised Basel III framework, among others, a new definition of the leverage ratio and a leverage ratio buffer, which prevent institutions from excessively increasing leverage, as well as a more favourable prudential treatment of certain software assets, a more favourable treatment of certain loans backed by pensions or salaries, a revised supporting factor for loans to small and medium-sized enterprises (SMEs), and a supporting factor for infrastructure projects.

- (3) The severe economic shock caused by the COVID-19 pandemic and the exceptional containment measures have a far-reaching impact on the economy. Businesses are facing disruption in supply chains, temporary closures and reduced demand, while households are confronted with unemployment and a fall in income. Public authorities at Union and Member State level have taken decisive actions to support households and solvent undertakings to withstand this severe but temporary slowdown in economic activity and the liquidity shortages it causes.
- (4) Institutions will have a key role in contributing to the recovery. At the same time they are likely to be impacted by the deteriorating economic situation. Competent authorities have provided temporary capital, liquidity and operational relief to institutions to ensure that they can continue to fulfil their role in funding the real economy in a more challenging environment. The Commission, the European Central Bank and the European Banking Authority have provided clarity on the application of the flexibility already embedded in Regulation (EU) No 575/2013 by issuing interpretations and guidance on the application of the prudential framework in the context of COVID-19¹⁶. In reaction to the COVID-19 pandemic, BCBS has also provided some flexibility in the application of international standards¹⁷.

sector exposures denominated in the domestic currency of any Member State (OJ L 345, 27.12.2017, p. 27).

¹⁴ Regulation (EU) 2019/630 of the European Parliament and of the Council of 17 April 2019 amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures (OJ L 111, 25.4.2019, p. 4).

¹⁵ Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 (OJ L 150, 7.6.2019, p. 1).

¹⁶ This includes the Communication from the Commission to the European Parliament and the Council - Commission Interpretative Communication on the application of the accounting and prudential frameworks to facilitate EU bank lending - Supporting businesses and households amid COVID-19, COM(2020)169 of 28.04.2020; the Press release “ECB Banking Supervision provides further flexibility to banks in reaction to coronavirus” and accompanying FAQs, 20 March 2020, <https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200320~4cddbcbf466.en.html>; EBA Statement on the application of the prudential framework regarding Default, Forbearance and IFRS9 in light of COVID-19 measures, 25 March 2020, available at: <https://eba.europa.eu/eba-provides-clarity-banks-consumers-application-prudential-framework-light-covid-19-measures>.

¹⁷ See press release “Basel Committee sets out additional measures to alleviate the impact of Covid-19”, 3 April 2020, <https://www.bis.org/press/p200403.htm>

- (5) It is important that institutions employ their capital where it is most needed and the Union regulatory framework facilitates this, whilst ensuring that institutions act prudently. Further to the flexibility provided in the existing rules, targeted changes to Regulation (EU) No 575/2013 would ensure that that prudential framework interacts smoothly with the various measures that address the COVID-19 emergency.
- (6) The extraordinary circumstances of the COVID-19 pandemic and the unprecedented magnitude of challenges triggered call for immediate action to ensure that institutions have the conditions to effectively channel funds to businesses and households and to absorb the economic shock caused by the COVID-19 pandemic.
- (7) Guarantees provided in the context of the COVID-19 pandemic by national governments or other public entities, which are eligible as credit protection providers under the credit risk mitigation rules set out in Chapter Four of Part Three of Regulation (EU) No 575/2013 are comparable regarding their risk mitigating effects to guarantees provided by official export credit agencies as referred to in Article 47c of Regulation (EU) No 575/2013. It is therefore justified to align the minimum coverage requirements for non-performing exposures benefiting from guarantees granted by national governments or other public entities to those benefiting from guarantees granted by official export credit agencies. Therefore, guarantees and counter-guarantees that are extended in the context of the COVID-19 pandemic in accordance with State aid rules should be treated in the same way as guarantees provided by official export credit agencies.
- (8) Evidence emerged in the context of the COVID-19 pandemic has made apparent that the possibility to temporarily exclude certain central bank exposures from the calculation of an institution's total exposure measure, as laid down in Article 429a of Regulation (EU) No 575/2013 as amended by Regulation (EU) 2019/876, could prove essential during a crisis situation. However, the effectiveness of this measure appears to be hampered by the reduced flexibility stemming from the offsetting mechanism attached to such temporary exclusions that would constrain the ability of institutions to increase central bank exposures in a crisis situation. This could ultimately result in forcing the institution to reduce the level of lending to households and businesses. In order to avoid any undesired consequences related to the offsetting mechanism and to ensure the effectiveness of that exclusion in the face of possible future shocks and crises, the offsetting mechanism should be modified before the leverage ratio requirement set out in point (d) of Article 92(1) of Regulation (EU) No 575/2013 becomes applicable in accordance with Union law on 28 June 2021. Pending the application of the amended provisions on the calculation of the leverage ratio as introduced by Regulation (EU) 2019/876, Article 429a should continue to apply as introduced by the Commission Delegated Regulation (EU) 2015/62¹⁸.
- (9) A large part of the institutions operating in the Union have been subject to IFRS 9 as of 1 January 2018. In line with international standards adopted by the BCBS, Regulation (EU) 2017/2395 introduced in Regulation (EU) No 575/2013 transitional arrangements to mitigate the potentially significant negative impact on institutions' Common Equity Tier 1 capital arising from expected credit loss accounting under IFRS 9.

¹⁸ Commission Delegated Regulation (EU) 2015/62 of 10 October 2014 amending Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to the leverage ratio, OJ L 11, 17.1.2015, p.37-43

- (10) The application of IFRS 9 during the economic downturn caused by the COVID-19 pandemic may lead to a sudden significant increase in expected credit loss provisions, as for many exposures expected losses over their lifetime may need to be calculated. The BCBS agreed on 3 April 2020 to allow more flexibility in the implementation of the transitional arrangements that phase in the impact of IFRS 9. In order to limit the possible volatility of regulatory capital that may occur if the COVID-19 crisis results in a significant increase in expected credit loss provisions, it is necessary to extend the transitional arrangements also in Union law.
- (11) To mitigate the potential impact that a sudden increase in expected credit loss provisions may have on institutions' capacity to lend to clients at times when it is most needed, the transitional arrangements should be extended by two years and institutions should be allowed to fully add-back to their Common Equity Tier 1 capital any increase in new expected credit loss provisions that they recognise in 2020 and 2021 for their financial assets, which are not credit-impaired. This would bring additional relief to the impact of the COVID-19 crisis on institutions' possible rise in provisioning needs under IFRS 9 while maintaining the transitional arrangements for the expected credit loss amounts established before the pandemic of COVID-19.
- (12) Institutions that opted not to use the transitional arrangements previously are able to reverse that decision anytime during the transitional period subject to prior approval from their competent authority. Subsequently and subject to supervisory approval, institutions have a possibility to opt out from using the transitional arrangements.
- (13) In March 2020, the Group of Central Bank Governors and Heads of Supervision (GHOS) has revised the implementation timeline of the final elements of the Basel framework. Whilst most of the final elements still need to be implemented in Union law, the leverage ratio buffer requirement for global systemically important institutions has already been implemented through the amendments brought by Regulation (EU) 2019/876. Therefore, the date of application for the leverage ratio buffer requirement should be deferred by one year to 1 January 2023, as agreed internationally. The date of application set in Regulation (EU) 2019/876 should be revised accordingly in order to ensure a level playing field internationally for institutions established in the Union and operating outside the Union. With the application of the leverage ratio buffer requirement postponed, during the postponement period there would be no consequences for the failure to meet that requirement as set out in Article 141c of Directive 2013/36/EU and no related restriction on distributions set out in Article 141b of that Directive.
- (14) Given the specific guarantees attached to loans granted by credit institutions to pensioners or employees with a permanent contract against the unconditional transfer of part of the borrower's pension or salary to that credit institution, Article 123 of Regulation (EU) No 575/2013 was amended by Regulation (EU) 2019/876 to allow for a more favourable treatment of such loans. The application of this treatment in the context of the COVID-19 pandemic would incentivise institutions to increase lending to employees and pensioners. It is therefore necessary to advance the date of application of that provision so that it can be used by institutions already during the COVID-19 pandemic.
- (15) The provisions on the adjustment of risk-weighted non-defaulted SME exposures set out in Article 501 of Regulation (EU) No 575/2013 (the SME supporting factor) have been amended by Regulation (EU) 2019/876. That Regulation also introduced in Article 501a of Regulation (EU) No 575/2013 a new adjustment to own funds

requirements for credit risk for exposures to entities that operate or finance physical structures or facilities, systems and networks that provide or support essential public services (the infrastructure supporting factors). As those supporting factors allow a more favourable treatment of certain exposures to SMEs and infrastructure, their application in the context of the COVID-19 pandemic would incentivise institutions to increase much needed lending to those entities. It is therefore necessary to advance the date of application of the two supporting factors so that they can be used by institutions already during the COVID-19 pandemic.

- (16) The prudential treatment of certain software assets has been amended by Regulation (EU) 2019/876 in order to further support the transition towards a more digitalised banking sector. In the context of the accelerated up-take of digital services as a consequences of public measures adopted to address the COVID-19 pandemic, the application of these changes should be anticipated.
- (17) Since the objectives of this Regulation, namely to maximise the capacity of credit institutions to lend and to absorb losses related to the COVID-19 pandemic, while still ensuring their continued resilience, cannot be sufficiently achieved by the Member States but can rather, by reason of their scale and effects, be better achieved at Union level, the Union may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union. In accordance with the principle of proportionality, as set out in that Article, this Regulation does not go beyond what is necessary in order to achieve those objectives.
- (18) For the extraordinary support measures adopted to alleviate the impact of the COVID-19 pandemic to be fully effective with regard to keeping the banking sector more resilient and providing an incentive to the institutions to continue lending, it is necessary for the alleviating effect of those measures to be immediately reflected in the way in which regulatory capital requirements are determined. Having regard to the urgency of those adjustments to the prudential framework, this Regulation should enter into force on the day following that of its publication in the Official Journal of the European Union.
- (19) Given that urgency, it is considered necessary to use the exception from the eight-week period referred to in Article 4 of Protocol No 1 on the role of National Parliaments in the European Union, annexed to the Treaty on European Union, to the Treaty on the Functioning of the European Union and to the Treaty establishing the European Atomic Energy Community.
- (20) Regulations (EU) No 575/2013 and (EU) 2019/876 should therefore be amended accordingly,

HAVE ADOPTED THIS REGULATION:

Article 1
Amendments to Regulation (EU) No 575/2013

Regulation (EU) No 575/2013 is amended as follows:

- (1) Article 429a, as amended by Regulation (EU) 2019/876, is amended as follows:
 - (a) in paragraph 1, the introductory phrase of point (n) is replaced by the following:

“(n) the following exposures to the institution's central bank, subject to the conditions set out in paragraphs 5 and 6.”;

- (b) in paragraph 7, the definitions of ‘EM_{LR}’ and ‘CB’ are replaced by the following:

“EM_{LR} = the institution's total exposure measure as defined in Article 429(4), including the exposures excluded in accordance with point (n) of paragraph 1 of this Article, on the day of the public declaration referred to in point (a) of paragraph 5 of this Article; and

CB = the total value of the institution’s exposures to its central bank that are eligible to be excluded in accordance with point (n) of paragraph 1, on the day of the public declaration referred to in point (a) of paragraph 5.”;

- (2) Article 473a is amended as follows:

- (a) paragraph 1 is amended as follows:

- (i) in the first subparagraph; the introductory phrase is replaced by the following:

“By way of derogation from Article 50 and until the end of the transitional periods set out in paragraphs 6 and 6a of this Article, the following may include in their Common Equity Tier 1 capital the amount calculated in accordance with this paragraph.”;

- (ii) the second subparagraph is replaced by the following:

“The amount referred to in the first subparagraph shall be calculated as the sum of the following:

- (a) for exposures which are subject to risk weighting in accordance with Chapter 2 of Title II of Part Three, the amount (AB_{SA}) calculated in accordance with the following formula:

$$AB_{SA} = (A_{2,SA} - t_1) \times f_1 + (A_{4,SA} - t_2) \times f_2$$

where:

A_{2,SA} = the amount calculated in accordance with paragraph 2;

A_{4,SA} = the amount calculated in accordance with paragraph 4 based on the amounts calculated in accordance with paragraph 3;

f₁ = the applicable factor laid down in paragraph 6;

f₂ = the applicable factor laid down in paragraph 6a;

t₁ = the increase of Common Equity Tier 1 capital that is due to tax deductibility of the amount A_{2,SA};

t₂ = the increase of Common Equity Tier 1 capital that is due to tax deductibility of the amount A_{4,SA};

- (b) for exposures which are subject to risk weighting in accordance with Chapter 3 of Title II of Part Three, the amount (AB_{IRB}) calculated in accordance with the following formula:

$$AB_{IRB} = (A_{2,IRB} - t_1) \times f_1 + (A_{4,IRB} - t_2) \times f_2$$

where:

A_{2,IRB} = the amount calculated in accordance with paragraph 2 adjusted in accordance with point (a) of paragraph 5;

$A_{4,IRB}$ = the amount calculated in accordance with paragraph 4 based on the amounts calculated in accordance with paragraph 3 which are adjusted in accordance with points (b) and (c) of paragraph 5;

f_1 = the applicable factor laid down in paragraph 6;

f_2 = the applicable factor laid down in paragraph 6a;

t_1 = the increase of Common Equity Tier 1 capital that is due to tax deductibility of the amount $A_{2,IRB}$;

t_2 = the increase of Common Equity Tier 1 capital that is due to tax deductibility of the amount $A_{4,IRB}$ ”;

(b) in paragraph 3, point (b) is replaced by the following:

“(b) the sum of the 12-month expected credit losses determined in accordance with paragraph 5.5.5 of the Annex relating to IFRS 9 and the amount of the loss allowance for lifetime expected credit losses determined in accordance with paragraph 5.5.3 of the Annex relating to IFRS 9 excluding the loss allowance for lifetime expected credit losses for financial assets that are credit-impaired as defined in Appendix A to the Annex relating to IFRS 9 as of 1 January 2020 or on the date of initial application of IFRS 9, whichever is later.”;

(c) in paragraph 5, point (c) is replaced by the following:

“(c) institutions shall replace the amount calculated in accordance with point (b) of paragraph 3 of this Article by the sum of the 12-month expected credit losses determined in accordance with paragraph 5.5.5 of the Annex relating to IFRS 9 and the amount of the loss allowance for lifetime expected credit losses determined in accordance with paragraph 5.5.3 of the Annex relating to IFRS 9 excluding the loss allowance for lifetime expected credit losses for financial assets that are credit-impaired, as defined in Appendix A to the Annex relating to IFRS 9, as of 1 January 2020 or on the date of initial application of IFRS 9, whichever is later, reduced by the sum of related expected loss amounts for the same exposures calculated in accordance with Article 158(5), (6) and (10). Where the calculation results in a negative number, the institution shall set the value of the amount referred to in point (b) of paragraph 3 of this Article as equal to zero.”;

(d) paragraph 6 is replaced by the following:

“6. Institutions shall apply the following factors f_1 to calculate the amounts AB_{SA} and AB_{IRB} referred to in points (a) and (b) of the second subparagraph of paragraph 1 respectively:

(a) 0,7 during the period from 1 January 2020 to 31 December 2020;

(b) 0,5 during the period from 1 January 2021 to 31 December 2021;

(c) 0,25 during the period from 1 January 2022 to 31 December 2022;

(d) 0 during the period from 1 January 2023 to 31 December 2024.

Institutions whose financial year commences after 1 January 2020 but before 1 January 2021 shall adjust the dates in points (a) to (d) of the first subparagraph so that they correspond to their financial year, shall report the adjusted dates to their competent authority and shall publicly disclose them.

Institutions which start to apply accounting standards as referred to in paragraph 1 on or after 1 January 2021 shall apply the relevant factors in accordance with points (b) to (d) of the first subparagraph starting with the factor corresponding to the year of the first application of those accounting standards.”;

- (e) the following paragraph 6a is inserted:

“6a. Institutions shall apply the following factors f_2 to calculate the amounts AB_{SA} and AB_{IRB} referred to in points (a) and (b) of the second subparagraph of paragraph 1 respectively:

- (a) 1 during the period from 1 January 2020 to 31 December 2020;
- (b) 1 during the period from 1 January 2021 to 31 December 2021;
- (c) 0,75 during the period from 1 January 2022 to 31 December 2022;
- (d) 0,5 during the period from 1 January 2023 to 31 December 2023;
- (e) 0,25 during the period from 1 January 2024 to 31 December 2024.

Institutions whose financial year commences after 1 January 2020 but before 1 January 2021 shall adjust the dates in points (a) to (e) of the first subparagraph so that they correspond to their financial year, shall report the adjusted dates to their competent authority and shall publicly disclose them.

Institutions which start to apply accounting standards as referred to in paragraph 1 on or after 1 January 2021 shall apply the relevant factors in accordance with points (b) to (e) of the first subparagraph starting with the factor corresponding to the year of the first application of those accounting standards.”;

- (f) paragraph 7 is amended as follows:

(i) point (b) is deleted;

(ii) the following subparagraph is inserted:

“When recalculating the requirements laid down in this Regulation and in Directive 2013/36/EU for the purpose of the first subparagraph, the amount AB_{SA} referred to in point (a) of the second subparagraph of paragraph 1 shall be assigned a risk weight of 100 %.”;

- (g) paragraph 8 is replaced by the following:

“8. During the periods set out in paragraphs 6 and 6a of this Article, in addition to disclosing the information required in Part Eight, institutions that have decided to apply the transitional arrangements set out in this Article shall disclose the amounts of own funds, Common Equity Tier 1 capital and Tier 1 capital, the Common Equity Tier 1 capital ratio, the Tier 1 capital ratio, the total capital ratio and the leverage ratio they would have in case they were not to apply this Article.”;

- (h) paragraph (9) is amended as follows:

(i) in the first subparagraph, the second sentence is replaced by the following:

“Where an institution has received the prior permission of the competent authority, it may reverse its decision during the transitional period.”;

(ii) in the second subparagraph, the second and third sentences are replaced by the following:

“In such a case, the institution shall set A_4 and t_2 referred to in paragraph 1 as equal to zero. Where an institution has received the prior permission of the competent authority, it may reverse its decision during the transitional period.”;

(iii) the following subparagraphs are added:

“An institution that has decided to apply the transitional arrangements set out in this Article may decide not to apply paragraph 2 in which case it shall inform the competent authority of its decision without delay. In such a case, the institution shall set A_2 and t_1 referred to in paragraph 1 as equal to zero. An institution may reverse its decision during the transitional period provided it has received the prior permission of the competent authority.

Competent authorities shall notify EBA at least on an annual basis on the application of this Article by institutions under their supervision.”;

(3) the following article is inserted:

“Article 500a

Temporary treatment of public guarantees related to the COVID-19 pandemic

By way of derogation from Article 47c(3), until [date of entry into force of this amending Regulation + 7 years] the factors set out in Article 47c(4) shall also apply to the part of the non-performing exposure guaranteed by an eligible provider referred to in points (a) to (e) of Article 201(1), where, subject to compliance with Union State aid rules, where applicable, the guarantee or counter-guarantee is provided as part of support measures to assist borrowers amid the COVID-19 pandemic.

Article 2

Amendments to Regulation (EU) 2019/876

Article 3 of Regulation (EU) 2019/876 is amended as follows:

(1) the following paragraph 3a is inserted:

“3a. The following points of Article 1 of this Regulation shall apply from [date of entry into force of this amending Regulation]:

- (a) point (59), as regards the provisions on the treatment of certain loans granted by credit institutions to pensioners or employees laid down in Article 123 of Regulation (EU) No 575/2013;
- (b) point (133), as regards the provisions on adjustment of risk-weighted non-defaulted SME exposures laid down in Article 501 of Regulation (EU) No 575/2013;
- (c) point (134), as regards the adjustment to own funds requirements for credit risk for exposures to entities that operate or finance physical structures or facilities, systems and networks that provide or support essential public services laid down in Article 501a of Regulation (EU) No 575/2013 .”;

(2) paragraph 5 is replaced by the following:

“5. Point (46)(b) of Article 1 of this Regulation, as regards the new requirement for own funds for G-SIIs laid down in Article 92(1a) of Regulation (EU) No 575/2013, shall apply from 1 January 2023.”;

(3) paragraph 7 is replaced by the following:

“7. Point (18) of Article 1 of this Regulation, as regards point (b) of Article 36(1) of Regulation (EU) No 575/2013, containing the provision on the exemption from deductions of prudently valued software assets, shall apply from the date of entry into force of the regulatory technical standards referred to in Article 36(4) of Regulation (EU) No 575/2013.”.

Article 3

Entry into force and application

1. This Regulation shall enter into force on the day following that of its publication in the *Official Journal of the European Union*.
2. This Regulation shall apply from [date of entry into force of this amending Regulation] with the exception laid down in paragraph 3.
3. Point (1) of Article 1 of this Regulation, as regards the changes to Article 429a of Regulation (EU) No 575/2013, as amended by Regulation (EU) 2019/876, in relation to the offsetting mechanism attached to a temporary exclusion of certain central bank reserves, shall apply from 28 June 2021.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the European Parliament
The President

For the Council
The President