European banks' response to COVID-19 "Quick Fix" regulation and other measures

The original full study[1] presents data from 27 banking groups in 10 EU Member States, where it is found that banks have used COVID-19 relief measures extensively, with some cross-country differences as for the intensity of use. Flexibility in risk classification does not seem to have impaired banks' ability to report and recognise risk properly, even for loans under moratoria. The findings suggest that the impact of the measures on banks' credit supply has been overall positive and mainly driven by capital-enhancing measures such as the "Quick fix".

Check out the original full study by scanning this QR code!

Background

The COVID-19 pandemic has deeply affected societies and economies around the world. In an attempt to contain the multiple negative effects of the spread of the virus, policy makers implemented unprecedented and extraordinary containment measures along with several policy initiatives to support businesses and households affected by the pandemic. The interventions include a wide set of monetary, fiscal, regulatory and supervisory measures for the banking sector, mainly aimed to maintain banks' ability to provide funds to the economy.

The aim of the study is to investigate the usage of COVID-19 relief measures introduced to safeguard the banking system and their effect on banks' behaviour. The focus is on measures taken to support the banking system's ability to provide credit to the real economy. To this end, the measures under analysis are:

- monetary policy measures, and in particular the (targeted) injections of long-term liquidity (TLTRO);
- fiscal measures, namely loans under moratoria and subject to public guarantees;
- measures introducing flexibility in prudential, supervisory, and resolution practices; and
- measures introducing changes in extant rules, such as the restrictions on dividends distributions and the adjustment to prudential regulation ("Quick-fix").

Specifically, the study aims to address the following questions: Have banks adjusted their balance sheets in response to these measures, and how? Have these measures been detrimental in terms of proper risk monitoring of loan portfolios? Have banks actually increased lending as an effect of the introduction of the COVID-19 measures?

The analysis was carried out on a sample of 27 large European banking groups, corresponding to 50 % of banking assets in the 10 EU Member States considered.

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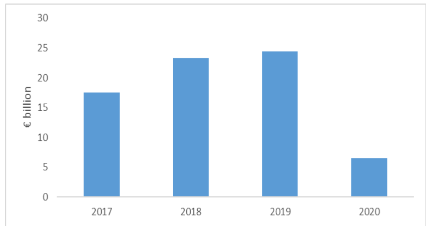
Key findings

The first finding is that banks have used COVID-19 relief measures extensively, although there are some cross-country differences regarding the intensity of their usage. In particular, the monetary policy intervention in terms of the TLTRO III, providing banks with funds at negative rates to lend to businesses, was widely used across banks and countries. This contrasts with previous liquidity interventions by the ECB in the context of the European sovereign debt crisis, when banks from peripheral countries were the most active users of the ECB borrowing facilities. On the other hand, the usage of borrower relief measures (moratoria and public credit guarantees) that are implemented at the national level was heterogeneous. Moratoria were widely used in high debt countries, and for longer maturities. Public credit guarantees were mostly concentrated in the large, core Member States, with little availability in smaller countries.

About the effect of the measures on risk monitoring, the case of risk reporting of loans under moratoria, one of the key areas of concern among bank supervisors, was analysed in particular. The empirical analysis shows systematic and consistent application of EBA guidelines, with few data gaps. The increasing trend in loan loss provisions and share of loans under moratoria where credit risk has increased significantly (i.e., loans in Stage 2 under the IFRS 9 classification) suggests careful loan monitoring on part of banks. Similarly, the emergence of a culture of forbearance could not be observed, as while asset quality deteriorated for loans under moratoria more so than for loans not in moratoria, the level of provisioning and loan coverage ratios also increased, reflecting the banks' capacity to bear future losses on these loans. It was however not possible to establish the extent to which the additional provisioning was adequate, given the lack of information on future recovery rates.

Total dividends paid, 2017-2020



Source: Author's own elaboration. Data from 14 largest publicly listed banks in the sample.

Another important finding concerns the impact of the measures on bank capital. The most effective capital-enhancing measures were the "Quick-fix" temporary amendments (the IFRS 9 transitional arrangements and the SME supporting factor). The dividends pay-out ban was an effective but probably temporary way to reinforce banks' capital position, as banks started paying back as soon as the regulation allowed them to do so. Finally, an estimate of the impact of these measures on lending was provided. Identifying the causal impact of shocks to bank capital on loan supply is a difficult empirical task, because capital and lending are correlated with the economic cycle. Isolating the causal effect of the COVID-relief measures on banks' lending and funding policies is even more challenging because these measures were designed and implemented simultaneously, together with other support measures such as monetary policy easing.

This problem was addressed by measuring how COVID-relief initiatives affected credit supply indirectly, namely via their impact on capital ratios. An estimate elasticity of lending with respect to capital as found in the existing academic literature was then used. Hence, multiplying this estimated elasticity by the change in capital induced by "Quick-fix" measures enabled to estimate the potential impact of the measures on bank credit supply. Given the total amount of credit in the sample of banks in 2019, this translates into an estimate of EUR 63 billion of additional credit. Summing up, the finding suggests that about half of the observed credit increase in the sample banks (corresponding to EUR 123 billion) could be due to the implementation of the "Quick-fix" regulation and its effect on bank capital. This amount is likely to represent a lower bound as some other measures may have also played a role, including the liquidity injections under the TLTRO program and loans provided under the public guarantee scheme.

[1] Bruno, B., 2021, European Banks' Response to COVID-19 "Quick Fix" Regulation and Other Measures, Publication for the committee on Economic and Monetary Affairs, Policy Department for Economic, Scientific and Quality of Life Policies, European Parliament, Luxembourg. Available at: https://www.europarl.europa.eu/RegData/etudes/STUD/2021/695460/IPOL_STU(2021)695460_EN.pdf.

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