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# EUROPEAN BANKING NEWSLETTER

AUGUST 2020

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## EUROPEAN FINANCIAL INSTITUTIONS BLOG

We are pleased to announce the launch of our European Financial Institutions Blog, which provides updates on legal and regulatory developments affecting financial institutions operating across Europe.

Please click [here](#) to access it and subscribe for new Blog alerts. Future editions of this newsletter will also be hosted on the Blog.

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## NEWS FROM THE ECB

### **COVID-19 - ECB publishes article on supervisory impact on EU banking business and the future shape of the sector**

7 July 2020 - The European Central Bank (ECB) has published an article by Kerstin af Jochnick, (Member of the ECB Supervisory Board) entitled ‘*Supervising the new normal*’, considering the regulatory landscape for EU banking business in the wake of COVID-19. Some of the key points emerging from the article include that:

- the crisis “*has redefined what constitutes meaningful supervisory engagement, in both a conceptual and an operational sense*”. Many of the indicators normally associated with banks’ financial deterioration pre-COVID-19 may no longer hold the same signalling value and therefore need to be reconsidered. Moreover, social distancing rules and travel restrictions have precluded the use of parts of supervisory toolkits;
- non-performing loans (NPLs) are very likely to increase in the future. Although the ECB is likely to exercise flexibility when implementing its guidance on NPLs to help banks cope with the impact of the current economic downturn, it is important for banks to have tight loan deterioration monitoring and management strategies enabling them to identify risks at an early stage;
- COVID-19 is likely to accelerate some of the regulatory trends observed pre-crisis, including digitalisation as an integral part of banks’ business models and challenges to profitability; and
- temporary linkages between domestic banking systems and their respective sovereigns as a result of government guarantees to banks, and the requirement of payment moratoria, should not become entrenched.

ECB article on the impact of COVID-19 on EU banking business is [here](#).

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### **CRR - ECB Guidelines on materiality threshold for credit obligations past due for less significant institutions published in the Official Journal**

8 July 2020 - Guideline (EU) 2020/978 of the ECB of 25 June 2020, on the exercise of discretion under Article 178(2)(d) of the Capital Requirements Regulation (575/2013/EU) by national competent authorities (NCAs) in relation to less significant institutions (LSIs) with regard to the threshold for assessing the materiality of credit obligations past due, has been published in the Official Journal of the European Union. The ECB adopted the Guidelines in June 2020 following its prior consultation in January 2020.

The Guidelines set a single materiality threshold for all LSIs within the Single Supervisory Mechanism (SSM) in respect of both retail and non-retail exposures. The threshold comprises: (i) an absolute component, detailing the specific maximum amount for the sum of all amounts past due owed by an obligor; and (ii) a relative component, a percentage reflecting the amount of the credit obligation past due in relation to the total amount of all on-balance sheet exposures to that obligor for the credit institution, the parent undertaking, or any of its subsidiaries.

The new Guidelines align the threshold definition with that used for banks supervised by the ECB under ECB Regulation (EU) 2018/1845.

The Guidelines take effect on the day of its notification to the NCAs of the participating member states. NCAs must comply with the Guidelines by no later than 31 December 2020.

Official Journal: ECB Guidelines on materiality threshold for credit obligations past due for less significant institutions under the CRR is [here](#).

Press release is [here](#).

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### **Brexit transition period - ECB publishes article on banks' preparations**

9 July 2020 - The ECB has published an article by Yves Mersch (Executive Member of the ECB Board and Vice-Chair of the ECB Supervisory Board) on banks' preparations for the end of the Brexit transition period on 31 December 2020.

Among other things, he states that a recent assessment undertaken by the ECB on banks' preparedness identified three priority areas for banks to focus on: (i) contingency planning; (ii) strengthening risk management and governance arrangements; and (iii) reducing the remote booking of EU activities to enable banks to retain full local oversight of their business. He also cautions banks from relying on equivalence decisions as part of their contingency planning, stating that, while equivalence can offer limited additional possibilities to banks in the short term, it does not constitute a sustainable basis for their business models and does not replicate the benefits of passporting or cover all regulated activities.

ECB article on banks' preparations ahead of the end of the Brexit transition period is [here](#).

### **COVID-19 - ECB publishes updated Recommendation on dividend distributions**

27 July 2020 - The ECB has published an updated Recommendation to banks extending its recommendation not to pay dividend distributions or facilitate share buybacks from 1 October 2020 until 1 January 2021 in light of the economic impact of COVID-19. For the same purpose, the ECB issued a letter to banks asking them to be extremely moderate with regard to variable remuneration payments, for example by reducing the overall amount of variable pay.

The ECB also clarified that it will give enough time for banks to replenish their capital and liquidity buffers in order not to act pro-cyclically. The ECB commits to allow banks to operate below the Pillar 2 Guidance and combined buffer requirement until at least end-2022, and below the Liquidity Coverage Ratio until at least end-2021, without automatically triggering supervisory actions. The ECB does not plan to extend the six month operational relief measures it granted to banks in March 2020, with the exception of NPL reduction strategies for high-NPL banks.

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Finally, the ECB has also published a letter to banks clarifying its expectations regarding risk management practices and operational capacity to deal with distressed debtors in light of COVID-19. Among other things, the ECB expects credit institutions to: (i) have in place effective risk management practices that identify, assess and implement solutions that can support businesses; and (ii) proactively identify and engage with potentially distressed borrowers ahead of the expiry of relevant payment moratoria to avoid negative impacts on banks' loan portfolios. The letter also sets out a number of specific operational elements, such as IT resources, reporting, and portfolio segmentation, that the ECB will assess through its ongoing engagement with credit institutions.

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Updated ECB Recommendation on dividend distributions in light of COVID-19 is [here](#).  
ECB letter regarding banks' ongoing remuneration policies in light of COVID-19 is [here](#).  
ECB letter regarding banks' risk management practices and operational capacity to deal with distressed debtors in light of COVID-19 is [here](#).  
ECB FAQs on its COVID-19 supervisory measures is [here](#).  
Press release is [here](#).

### **TARGET2 and TARGET2-Securities - ECB postpones consolidation project in light of COVID-19**

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*28 July 2020* - The ECB has announced that, following discussions with relevant stakeholders, it has decided to postpone by 12 months the implementation of its project to consolidate various technical and functional elements of TARGET2 and TARGET2-Securities. This includes the implementation of a new trans-European automated real-time gross settlement express transfer system using the ISO 20022 messaging standard. The project is now scheduled to go live in November 2022.

Press release: ECB postpones T2-T2S consolidation project until November 2022 is [here](#).

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### **COVID-19 - ECB publishes results of analysis on banks' vulnerability**

*28 July 2020* - The ECB has published the results of its vulnerability analysis of banks directly supervised within the SSM. The exercise assessed how the economic impact and disruption caused by COVID-19 would impact 86 euro area banks and aimed to identify potential vulnerabilities within the banking sector over a three-year timescale. Overall, the ECB confirms that the results demonstrate that the euro area banking sector can withstand the economic stress induced by COVID-19.

In light of the extraordinary current circumstances and in order to avoid subjecting banks to additional operational burdens, the ECB used already available data for this exercise, including regular supervisory reporting.

ECB COVID-19 vulnerability analysis results is [here](#).

Press release is [here](#).

### **Benchmark rate reforms - ECB publishes report on banks' preparations**

*July 2020* - The ECB has published a report on banks' preparedness for benchmark rate reforms. The report includes good practice guidance outlining how banks can best structure their benchmark rate-related governance and identify benchmark reform-related risks.

Among other things, the report states that while banks are generally well aware of the complexity of the reforms and the challenges involved, their level of preparation leaves room for improvement. The report also states that banks are generally behind schedule in implementing risk mitigation measures and have tended to focus more on the transition from the euro overnight index average (EONIA) to the euro short-term rate (€STR) than on the risks associated with the reform of the euro interbank offered rate (EURIBOR). This is despite the fact that EURIBOR is currently the most frequently used benchmark rate for contracts in the euro area.

ECB report on banks' preparations for benchmark rate reforms is [here](#).

Press release is [here](#).

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### **Transition from EONIA to €STR - ECB consults on the publication of compounded term rates using €STR**

*July 2020* - The ECB has launched a consultation on the publication of compounded term rates using the €STR. The consultation outlines the ECB's proposals to publish compounded term rates based on €STR on a daily basis shortly after €STR is published, with published maturities ranging from one week to one year. The ECB also proposes publishing a daily index, making it possible to compute compounded rates over non-standard periods. The ECB states that this initiative aims to encourage and support the wider use of €STR as a rate that can be used in contractual fallback provisions in contracts using the euro London interbank offered rate (EURO LIBOR) and the EURIBOR.

The consultation document sets out the proposed rate compounding formula, index calculation methodology and publication policies. The ECB also seeks views on day-count conventions, stating that it proposes determining tenors using the European modified previous business day convention.

The consultation period closes on 11 September 2020.

ECB consultation on the publication of compounded term rates using the €STR is [here](#). Press release is [here](#).

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**Please see the Single Supervisory Mechanism (SSM) section for items on the ECB's and SRB's announcements of the accession of Bulgaria and Croatia to the Single Supervisory Mechanism and Single Resolution Mechanism respectively; and the ECB's consultation in relation to SSM bank consolidation supervision.**

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## NEWS FOR THE SINGLE SUPERVISORY MECHANISM (SSM)

### **Case T-203/18 VQ v European Central Bank**

8 July 2020 - Enforcement action fining and identifying a bank under the Single Supervisory Mechanism for breaching prudential rules - SSM Regulation (1024/2013/EU) – SSM Framework Regulation (468/2014/EU) - Capital Requirements Regulation (575/2013/EU)

The European General Court (Second Chamber, Extended Composition) has ruled that the European Central Bank (ECB) was correct in its enforcement action taken against a bank in the Single Supervisory Mechanism (SSM) under the framework set out in the SSM Regulation (1024/2013/EU) and the SSM Framework Regulation (468/2014/EU).

The applicant, VQ, a bank subject to the ECB's prudential rules, sought an annulment of the ECB's decision to impose a financial penalty of €1,600,000 pursuant to Article 18(1) of the SSM Regulation for having repurchased its own shares without the prior permission of the competent authority, and to publish that decision on the ECB's website. The General Court held that it was not disproportionate for the ECB to impose a financial penalty, rather than a less serious disciplinary option, as Article 18 of the SSM Regulation gives the ECB discretion to decide whether an individual breach justifies the imposition of a penalty. Moreover, the publication of VQ's identity in the financial penalty notification did not cause "*disproportionate damage*" for the purposes of Article 132(1)(b) of the SSM Framework Regulation.

Case T-203/18 VQ v European Central Bank is [here](#).



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## Single Supervisory Mechanism - ECB announces accession of Bulgaria and Croatia

*13 July 2020* - The ECB has announced that Bulgaria and Croatia have joined the Single Supervisory Mechanism (SSM) and states that it has adopted decisions to establish close cooperation with the central banks of both countries. The effect of this decision is that, from 1 October 2020, the ECB will be responsible for the direct supervision of significant credit institutions in Bulgaria and Croatia and common procedures for all such supervised entities. In addition to this, the ECB will have oversight of less significant institutions in both countries. Prior to this date, the ECB will assess which banks fulfil the criteria to be classified as significant institutions.

The Single Resolution Board confirmed that the effect of these decisions is that Bulgaria and Croatia will also join the Single Resolution Mechanism (SRM) from 1 October 2020. From that point, it will become the resolution authority for significant credit institutions in these countries and all cross-border groups, as well having oversight of the resolution planning.

At a meeting of the Euro Accession Countries Working Group of the Committee on Economic and Monetary affairs of the European Parliament, Fabio Panetta (Member of the Executive Board of the ECB) stressed the importance of this development and that, now Bulgaria and Croatia have joined the banking union and their currencies have been included in the exchange rate mechanism, they may be able to adopt the euro by 'around' 2023.

The texts of these decisions have not yet been published and will apply 14 days after their publication in the Official Journal of the European Union.

ECB establishes close cooperation with Bulgaria's central bank is [here](#).

ECB establishes close cooperation with Croatia's central bank is [here](#).

ECB: Introductory remarks by Fabio Panetta – pursuing a successful path towards euro area accession is [here](#).

SRB: Bulgaria and Croatia set to join the Single Resolution Mechanism is [here](#).

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## **Single Supervisory Mechanism - ECB consults on supervisory approach to consolidation**

*July 2020* - The ECB has published for consultation a draft guide on its supervisory approach to consolidation for banks under the SSM. The ECB is responsible for ensuring that new entities emerging from relevant consolidations have sustainable business models, comply with prudential requirements and have sound governance and risk management arrangements in place. ‘Consolidation’ refers to any business combination of pre-existing independent legal entities, including mergers and acquisitions but not intra-group transactions.

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Although the guide is directed at circumstances in which a bank subject to the SSM intends to acquire the control of another bank subject to the SSM, the ECB suggests that the principles in the guide remain valid when a non-bank or non-SSM bank is involved.

The consultation period closes on 1 October 2020.

Draft ECB guide on its supervisory approach to the consolidation of banks under the SSM is [here](#).

Webpage is [here](#).

Press release is [here](#).

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### **Single Supervisory Mechanism - ECB announces organisational changes to strengthen banking supervision**

29 July 2020 - The ECB has announced changes to the organisational structure of its supervisory arm to ensure continued effective and efficient supervision of banks.

Two additional business areas will be created in the ECB's banking supervision arm – bringing the total to seven – and tasks will be redistributed across business areas. Bank-specific supervision will be organised according to banks' business models and will be supported by teams of risk or subject matter experts. Furthermore, activities such as supervisory strategy and risk, on-site supervision, and governance and operations will have dedicated business areas.

The changes are expected to be completed in the fourth quarter of 2020.

Press Release is [here](#).

**Please see the European Central Bank (ECB) section for an item on the ECB's publication of its analysis on SSM bank vulnerabilities.**

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## NEWS FOR THE SINGLE RESOLUTION MECHANISM (SRM)

### **Operational guidance on continuity in resolution and FMI contingency plans published by the SRB**

*July 2020* - The Single Resolution Board (SRB) has published guidance on operational continuity in resolution (OCIR) and on financial market infrastructure (FMI) contingency plans. This follows the publication by the SRB of its Expectations for Banks document in March 2020, which set out the capabilities the SRB expects banks to demonstrate in order to show that they are resolvable, including in relation to OCIR and access to FMIs.

The guidance on OCIR clarifies how banks can implement SRB expectations relating to: (i) service identification and mapping; (ii) assessments of operational continuity risk; and (iii) mitigating measures, including having adequately documented, resolution-resilient contracts, appropriate management information systems and governance arrangements. Further guidance may be provided on other OCIR topics in line with their phase-in.

The guidance on FMI contingency plans sets out the SRB's expectations with regard to the minimum content of FMI contingency plans prepared by banks. Among other things, it states that each bank is expected to develop an FMI contingency plan in line with the recommendations published by the Financial Stability Board in its guidance on continuity of access to FMIs for a firm in resolution, published in July 2017.

Press release: SRB publishes operational guidance on OCIR and FMI contingency plans is [here](#).

SRB operational guidance on operational continuity in resolution is [here](#).

SRB operational guidance on FMI contingency plans is [here](#).

**Please see the Single Supervisory Mechanism (SSM) section for an item on the ECB's and SRB's announcements of the accession of Bulgaria and Croatia to the Single Supervisory Mechanism and Single Resolution Mechanism respectively.**

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Our European Financial Institutions Group, consisting of ‘Best Friends’ BonelliErede, Bredin Prat, De Brauw Blackstone Westbroek, Hengeler Mueller, Slaughter and May and Uría Menéndez, brings together market-leading lawyers with corporate and financing experience and financial regulatory skills.

We have unrivalled coverage of regulatory developments in the EU, which enables us to provide pure regulatory advice on the interpretation and application of EU directives and regulations. We also have strong connections with the best financial institutions lawyers in the United States, Asia and South America.

Our many years of experience of advising a diverse range of major financial institutions allows us to offer the most incisive advice available.

If you would like to discuss any of the developments in this update, or any other financial regulatory matter, please contact one of the following or your usual EFIG contact.

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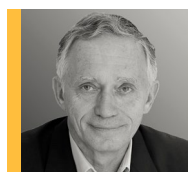
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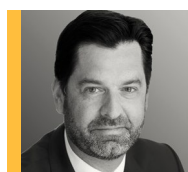
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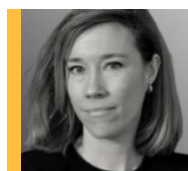
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