Client Alert | **Newsflash** | Financial Institutions Advisory

COVID-19 FAQ 3: What regulatory capital and leverage relief is available?

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This FAQ is intended to provide financial institutions with an overview of actions by central banks and regulators to grant COVID-19 related relief from compliance with regulatory capital, leverage and stress testing requirements otherwise applicable.

In contrast to their role in the 2008-09 crisis, banks are now part of the solution to the issues currently faced by the global economy. In the early stages of the COVID-19 crisis, prudential regulators quickly lowered banks' countercyclical capital buffers and reserve requirements for demand deposits, making clear their expectation that capital and liquidity buffers generally should be drawn down to allow banks to continue to extend credit to better support clients through the global economic shock.

Banks in many jurisdictions are now permitted to operate temporarily below certain required levels of capital and to use capital instruments that do not qualify as common equity tier 1 capital. Some exemptions to the supplementary leverage ratio have been made. Regulators' actions, along with direction from global policy coordinating bodies, were also aimed at supporting market liquidity, integrity and continuity, as well as loss absorption. In addition, market risk capital requirement calculations were temporarily adjusted to reduce procyclicality, and the application of the internal model method for counterparty credit risk exposures also was clarified.

Prudential and accounting regulators have given guidance on banks' application of international accounting rules for regulatory capital purposes, including the impact of repayment holidays on expected credit loss estimates and recognition of default. Bank stress tests have been cancelled or postponed, and flexibility extended to banks on prudential reporting timeframes. Bank supervisors globally have recognized that the current Basel III implementation schedule will be challenging and, in a coordinated move, have postponed various timelines by a year, including those for the revised leverage ratio, operational risk, market risk, credit valuation adjustment and Pillar 3 disclosure frameworks, standardized and internal ratings-based approaches for credit risk, and output floor.

Critics of these measures are uneasy about this temporary weakening of capital standards and point to moral hazard risks and a longer-term adverse impact on the sector. So supervisors are monitoring closely banks' reactions to this relief—and have made clear, in very strongly worded statements, their expectation to see them using the capital released to support their clients and the economy through this crisis. A strict reckoning of bank actions will be held once this current global shock looks to be coming to an end.

Global coordination: the Basel Committee

The Basel Committee has announced a series of measures (*see, also*) to provide additional operational capacity for banks and supervisors to respond to the immediate financial stability priorities resulting from COVID-19. In general, the Basel Committee has delayed implementation timetables and put policy changes on hold. The Basel Committee's announcement provides welcome flexibility to those jurisdictions still completing the implementation and transition processes.

According to the Basel Committee, these deferrals are not expected to dilute the capital strength of the global banking system, but will provide banks and supervisors additional capacity to respond effectively to COVID-19, consistent with the Basel Committee's view that banks should use capital resources to support the real economy and absorb losses.

Responses in specific jurisdictions

Jurisdiction	Regulatory capital relief highlights

United States	The US federal bank regulators have unleashed a flurry of rules and guidance in response to the COVID-19 pandemic to support financial markets and the economy generally and to encourage banks to continue to lend prudently amid increasing market uncertainty and economic contraction. Our alert contains additional detail. In short form the key reliefs are:
	• Recent rule changes that generally apply to banks, bank holding companies, US intermediate holding companies of non-US banks, savings associations and savings and loan holding companies:
	  • make technical changes to more gradually apply the automatic limitations on capital distributions following reductions in capital buffers (and TLAC for G-SIBs);
	  • reduce potential adverse effects under the capital rules of participating in the new Federal Reserve Money Market Mutual Fund Liquidity Facility ("MMLF"), which seeks to address liquidity pressure on money market mutual funds; and
	  • allow banking organizations to delay an estimate of the effect of the new Credit Losses on Financial Instruments (CECL) accounting standard's on regulatory capital.

Jurisdiction	Regulatory capital relief highlights
	• Temporary reduction in the leverage ratio for community banks, and exclusion of US Treasury securities and deposits at Federal Reserve Banks from the calculation of the supplemental leverage ratio for large holding companies.
European Union	ECB Banking Supervision provides temporary capital and operational relief: banks are allowed to operate temporarily below the level of capital defined by the Pillar 2 Guidance, the capital conservation buffer and the liquidity coverage ratio; and to partially use capital instruments that do not qualify as CET1 capital. The European Commission has adopted amendments to the EU's banking prudential rules (the "Capital Requirements Regulation, CRR") with the objective to optimize the ability of banks to lend in the real economy and absorb COVID-19 related losses. The main changes adopted under the banking package are: provision of a longer transition period for implementing the expected credit loss ("ECL") mechanism to alleviate the impact of increased ECL in times of COVID-19, more favorable treatment for public guarantees granted as crisis measures by member states, a deferral in the date of application of the leverage ratio buffer and modification in the calculation of the leverage ratio when exposures to central banks are allowed to be excluded. The Commission also advanced the dates of application of some measures amended by CRR 2 but not already in effect. Relevant links: Temporary capital and operational relief in reaction to coronavirus, EC Proposal to amend the Regulation
United Kingdom	The UK Bank of England, Prudential Regulation Authority and Financial Conduct Authority have been quick to issue various reliefs and grant flexibility to banks to facilitate the release of capital to support the UK economy, including the following: Countercyclical capital buffer rate lowered Bank stress test cancelled, supervisory programs postponed, IFRS 9 expected credit loss estimate clarified Dear CEO letter on IFRS 9 and regulatory capital Flexibility on reporting timelines and measures to increase information flow Temporary market risk capital relief Clarification of approach to calculating exposure under internal models method for counterparty credit risk Expectation that capital released should be used by banks to support the economy in 2020 Statement on Basel III implementation postponement Decision to maintain SRB rates at the rate set in December 2019 FAQ on usability of capital and liquidity buffers Statement on regulatory treatment of UK Coronavirus Loan Schemes Statement on credit risk mitigation eligibility and leverage ratio treatment of loans under Bounce Back Loan scheme Statement on conversion of Pillar 2A capital requirements from RWA percentage to nominal amount

Jurisdiction	Regulatory capital relief highlights
France	On April 1, 2020, the French Financial Stability Board decided on a complete relaxation of the current countercyclical buffer from 2.5 percent to 0 percent. The French banking regulator ("*Autorité de contrôle prudentiel et de résolution*—ACPR") is expected to take a position shortly on the EBA/GL/2020/02 guidelines dated April 2, 2020, on prudential treatment of exposures subject to legislative and non-legislative moratoria.
Germany	The German Financial Supervisory Authority ("BaFin") has reduced the requirements regarding banks' countercyclical capital buffer to 0 percent. Additional capital relief measures have been taken by the European Central Bank ("ECB") for significant institutions (*see* EU section). BaFin follows these ECB's measures for less significant institutions. *See* Link: Reduction of Countercyclical Capital Buffer (German).
Italy	The ECB has eased regulatory capital (Pillar 2 Guidance and capital conservation buffer) and liquidity coverage ratio requirements, and allowed banks to partially use AT1 and T2 instruments to meet the Pillar 2 Requirements. The Bank of Italy has applied to non-systemic banks the same regulatory capital relief adopted by ECB and set the countercyclical capital buffer at 0 percent for Q2 2020. *See*: Link
Spain	As of the current date, no specific capital relief measure has been approved in Spain. However, please note that all funding provided under the government's €100 billion line of public guarantees ("RDL8/2020"), will not imply capital consumption for the financial institutions involved in this.
Belgium	The National Bank of Belgium has decided to abolish the countercyclical capital buffer. The abolition of the countercyclical capital buffer offers additional capacity to absorb possible credit losses. The lifting of the countercyclical capital buffer will make approximately EUR 1 billion of capital buffers available. [1]*See* the NBB's official website (EN, FR, NL).
Sweden	Yes. The Swedish regulator has lowered the countercyclical capital buffer requirement for banks from 2.5 percent to 0 percent, which, in effect ,will release approx. EUR 80 billion of capital, making that capital available for lending to Swedish businesses. The new buffer rate is expected to apply until at least Q1 2022. *See*: Link
UAE	For banks regulated by the CBUAE, the Capital Conservation Buffer stays at 2.5 percent, but banks are allowed to tap into the capital conservation buffer up to a maximum of 60 percent without supervisory consequences, effective from March 15, 2020, for a period of one year. In addition, the CBUAE has decided to reduce by half the reserves requirements for demand deposits for all banks, from 14 percent to seven percent. This will inject liquidity of about AED 61 billion, which can be used to support banks' lending to the UAE economy and their liquidity management.

Our FIA team has developed the ***COVID-19 Regulatory and Legislative Dashboard*** *as a resource to help clients and affected institutions, companies, governments, other entities and individuals around the world navigate the complexities of the crisis and the policy response. Please refer to the Dashboard for our periodic updates and insights on the issues addressed in this FAQ*.

Find out more about the business response to the Coronavirus outbreak: ***Coronavirus: Managing business impact and legal risks***.

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