

UPDATE ON COVID-19 REGULATORY RESPONSES

VERONIQUE ORMEZZANO

Florence School of Banking & Finance, 2nd July 2020



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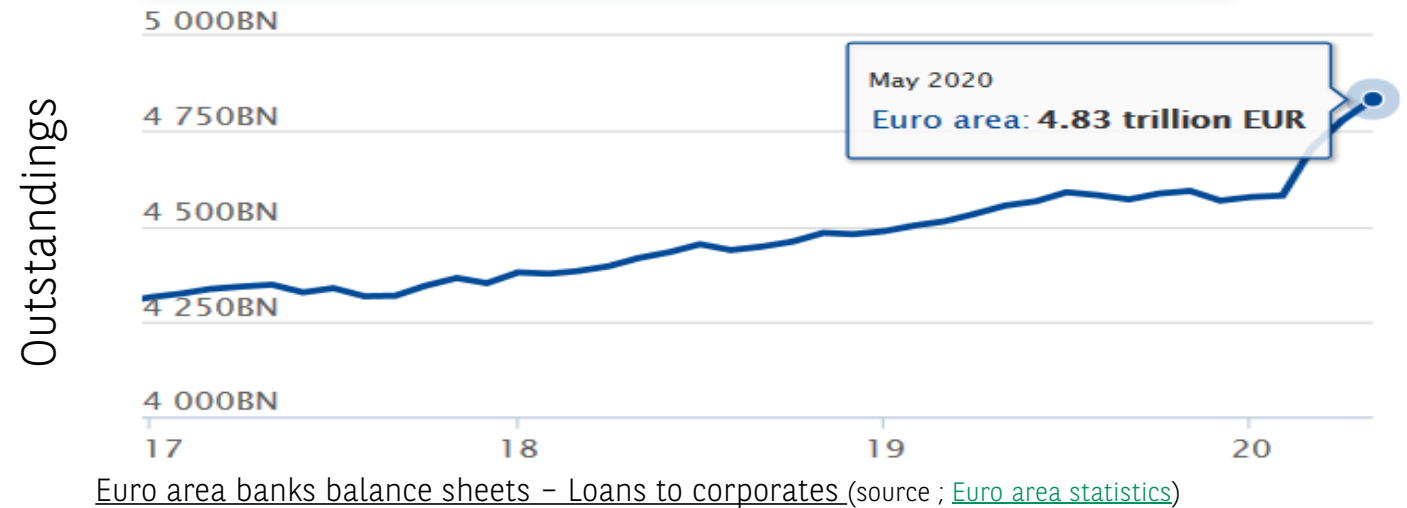
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EUROPEAN BANKS ARE PART OF THE SOLUTION, HAND IN HAND WITH POLICY MAKERS :

- From March to May, euro area banks outstandings to NFCs has increased by 250bn€
- Regulatory and supervisory reliefs provide a capacity of absorbing losses and potential lending, depending on the asset class RW, of 0.6 to 1.3tn€ (EBA)
 - But market stigma and fear of downgrades may limit the use of capital buffers
 - Relief exclusively focused on risk-based capital, not taking into account other dimensions of capital management : leverage, MREL/TLAC, Systemic scores, contributions and taxes
 - Amounts of unlocked lending, exclusively based on CET1 are misleading
 - Need a multi dimensional analysis, and balanced relief across all axis
- “Government loan guarantees could transfer over 30% of losses that materialise to governments, if fully deployed” (EBA)



FLEXIBILITY MEASURES ARE VERY WELCOME BUT WIDENING GAP WITH OTHER JURISDICTIONS:

		EUROPE	UNITED STATES	UK
Leverage	State Guaranteed Loans	No exemption from the leverage ratio for state-guaranteed loans	Paycheck Protection Program (PPP) totally exempt from the leverage ratio	UK Bounce Back Loan scheme and other 100% guaranteed loans <€60,000 exemption from the leverage exposure state-guaranteed loans.
	Central Bank Reserves	Central Banks reserves potentially exempted from the leverage ratio with partial maintenance of the off-setting factor	All Federal Reserve bank deposits exempt from leverage ratio (SLR) immediately	No exemption from the leverage ratio for central bank reserves specific to COVID - but previous exemptions had already been suggested by the PRA for banks subject to the UK leverage ratio.
	Sovereign securities	No exemption from the leverage ratio for sovereign securities	US Treasury securities exempt from leverage ratio (SLR) immediately	No exemption from the leverage ratio for sovereign securities
LIQUIDITY	LCR	No LCR neutralisation of the State Guaranteed Loans	Neutralisation of the Paycheck Protection Programme (PPP) in LCR	
	Central Bank Eligibility	High discount rate for State Guaranteed Loans (up to 40%)	Paycheck Protection Programme (PPP): 0% discount for refinancing in Central Bank	
		High haircuts on Asset Back Commercial Paper for ECB's refinancing	Term Asset-Backed Securities Loan Facility : This facility supports the market for asset-backed securities (inc. ABCP)	
MARKET RISK	Removal of pro-cyclical effects on market risk	VaR multiplier : Flexibility given to supervisors to exempt losses not due to model deficiencies	Authorization to apply the multiplication factor that applied as at December 31, 2019 to determine VaR and Stress VaR-based capital requirements for market risk until September 30, 2020, due to the impact of VIDIC-19 on financial markets.	Temporarily allow firms to offset increases due to new exceptions through a commensurate reduction in risks-not-in-VAR capital requirements.
		Assymetry of treatment of xVA hedges not addressed	CVA market hedges are excluded from the scope of calculation of market risk**.	
PUBLIC SUPPORT SCHEME	Supporting bank financing capacity	Lack of a government-supported European securitisation scheme	Main Street Lending Program: FED program with input from Treasury, allowing the purchase of business loans to support small and mid-size businesses	Lack of a government-supported securitisation scheme
Capital/MREL requirements	Capital/MREL requirements	Buffers usability with MDA flexibility limited to CCyB No recalibration of MREL Suspension of dividends until oct 2020 (ESRB : jan 2021)	MDA rules relaxed / No Pillar 2 No MREL (only the TLAC, which also applies to European banks) Suspension of buy-backs but dividends allowed with revised rules (subject to stress tests)	All Pillar 2A requirements are set as a nominal amount, instead of a percentage of total RWA Suspension of dividends and buy-backs

WHAT'S NEXT ?

1. Make urgent measures work

- **Regulatory uncertainty**
 - Moratoria (UK, third countries, syndicated loans ?)
 - Activation of quick fix measures (CB deposits exemption, software,...)
- **Fragmentation**
 - Various forms of public guarantees in each MS
 - Various levels of eligibility for Credit Risk Mitigation in CRR
 - Various/high haircuts in ECB collateral policy

2. Prepare for next challenges

- **Equity/quasi-equity injections**
 - From liquidity to solvency
- **Revive Capital Market Union**
 - Market making is key
 - Securitization more needed than ever
- **Revisit the NPL Action Plan**
 - Designed in a different context
 - Not realistic in the post-Covid world
 - Banks' socially responsible workout practices should be preferred, rather than accelerated provisioning as an incentive to sell

3. Toward the new normal

- Finance the **recovery**: Green, manufacturing relocalisation?, social infrastructure,...
- Ensure banks remains / **become investible again** : flexibility on dividends, MREL, SRF contributions...)
- Address **fragmentation** and progress in **integration** to ensure efficient transmission of monetary policy and sovereign debt resilience

7. LESSONS LEARNED ON REGULATORY FRAMEWORK

- Need for flexibility evidenced in the crisis
 - Credit Risk Mitigation approach too binary
 - Too much in level 1 texts ?
 - More trust in authorities ?
- Buffer usability does not work as it was intended
 - Hierarchy between AT1 and dividends ?
 - Less MDA buffers and more countercyclical buffers ?
 - Interaction with stress tests ?
 - Issues to be dealt with in CRR3/CRD6
- Excessive pro-cyclicality must be permanently removed
 - In current regulation (Prudal, IFRS9)
 - In new regulation : FRTB, OpRisk, ...
 - How to address back-testing of models : exclude Covid-related observations ?