EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Andrea ENRIA
Chair of the Supervisory Board

COURTESY TRANSLATION

Mr Marco Zanni
Ms Francesca Donato
Mr Valentino Grant
Mr Antonio Maria Rinaldi
Members of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 28 April 2021

Re: Your letter (QZ-014)

Honourable Members of the European Parliament, dear Mr Zanni, Ms Donato, Mr Grant and Mr Rinaldi,

Thank you for your letter on corporate failures caused by the coronavirus (COVID-19) pandemic, which was passed on to me by Ms Irene Tinagli, Chair of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 30 March 2021.

Regarding your first question on the potential impact of company bankruptcies on the balance sheets of European banks, corporate bankruptcies in the euro area decreased significantly in 2020 relative to 2019 levels as public authorities provided policy support and, in some cases, suspended mandatory insolvency filings.[1] Please note that ECB Banking Supervision is participating in the 2021 European Banking Authority (EBA) EU-wide stress test[2], the results of which the EBA intends to publish by the end of July 2021, and conducting a complementary exercise for other banks under direct ECB supervision.[3] These exercises include projecting the impact of bankruptcies and other possible deteriorations of credit exposures on the balance sheet of euro area banks under both a baseline and an adverse scenario. With regard to your question on the implications of bankruptcies on jobs, please note that while the ECB monitors labour market dynamics for monetary policy purposes, this falls outside the remit of ECB Banking Supervision.

[1] See experimental data published by the Eurostat for a selection of EU countries: https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Quarterly_registrations_of_new_businesses_and_declarations_of_bankruptcies_-_statistics#Quarterly_comparison_in_EU_and_euro_area

[2] See https://www.eba.europa.eu/eba-launches-2021-eu-wide-stress-test-exercise.

[3] See https://www.bankingsupervision.europa.eu/press/pr/date/2021/html/ssm.pr210129~69d2d006ec.en.html.

On your second question, I would first like to stress that in order to maintain a good overview of the risks in the banking sector, including in times of distress, it remains crucial to continue identifying and reporting asset quality deterioration as well as the build-up of non-performing loans (NPLs) in accordance with the existing rules and in a timely manner. Banks are encouraged to engage with distressed debtors at an early stage and to provide them with appropriate solutions in good time.

As mentioned in my letter to you of 4 December 2020,[4] addressing NPLs has been one of the key priorities for ECB Banking Supervision since its inception. The overall objective of developing the supervisory approach was to avoid "wait and see" approaches, which lead to an excessive build-up of NPLs and impair the ability of banks to support the economic recovery. This was a key lesson learnt from the last crisis, as delaying the recognition and resolution of NPLs increases problems in the longer term and makes them harder to tackle. The NPL coverage expectations are a very important element of our framework for facilitating timely NPL resolution. First, they ensure that banks build up the provisioning buffers that are required to address NPLs. Second, they provide a strong incentive for banks to address NPLs in a timely manner. We therefore find it very important that the NPL coverage expectations are not changed any further. As we already communicated in our FAQs on the ECB's supervisory measures[5] in response to the COVID-19 pandemic, our mitigation measures do not focus on the stock of NPLs accumulated prior to the outbreak.

In addition, the coverage expectations for loans originated from 26 April 2019 onwards have been included in the Capital Requirements Regulation (CRR) and it is therefore outside the competence of the ECB to consider temporary adjustments to this rule.

As regards any proposals to modify the EBA Guidelines on the definition of default, the current framework already provides banks with the flexibility to grant forbearance measures, ensuring that no automatic reclassification to default is needed for prudential purposes. Under the EBA Guidelines on payment moratoria in particular, the default assessment applicable to the restructuring of distressed debt is not to be automatically triggered in case of general payment moratoria.

As for your question related to the extension of Article 500 of the CRR, let me briefly note that said article was put in place to ensure that the supervisory pressure to reduce NPLs in 2016 did not also lead to an undue increase in capital requirements. However, Article 500 should not be used to prevent losses arising from naturally occurring events from being reflected in capital requirements. Instead, banks need to be adequately capitalised to withstand such events. The extension of Article 500, which is not within the ECB's remit, could lead to an undue underestimation of risk parameters and a lowering of capital requirements, and hence increase the risk to the taxpayer during the next crisis.

As for your question related to the calls for a temporary suspension of the final Basel III reforms, it is important to note that the reforms address weaknesses in the current regulatory framework. They reflect important lessons learned from the global financial crisis and address level playing field issues in the use of

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[4] https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.mepletter201204_Zanni_Donato_Grant_Rinaldi~37e7a4bd25.en.pdf?10a3f84d59483c0c4f5fda01df41a5cd

[5] See FAQ on ECB supervisory measures in reaction to the coronavirus https://www.bankingsupervision.europa.eu/press/publications/html/ssm.faq_ECB_supervisory_measures_in_reaction_to_the_coronavirus~8a631697a4.en.html

internal models. Moreover, the Basel Committee on Banking Supervision already agreed in March 2020 to delay the international implementation timeline for the final Basel III reform by one year with a view to freeing up operational capacity for banks and supervisors to respond to the economic impact of the COVID-19 pandemic. The implementation will now start in 2023 and entail a gradual phasing in of the new requirements until 2028. However, this timeline change does not affect the substance of the reforms and the COVID-19 pandemic does not call into question the validity of the framework. Instead, we need to continue strengthening the EU regulatory framework and implement the reforms in a full, timely and consistent manner.

Yours sincerely,

[signed]

Andrea Enria