EBA CLOSURE REPORT OF COVID-19 MEASURES

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Abbreviations

CA	Competent Authority
CCyB	Counter-cyclical buffer
CCB	Capital Conservation Buffer
CET1	Common Equity Tier 1
CRD	Directive 2013/36/EU of the European Parliament and of the Council
CRM	Credit Risk Mitigation
CRR	Regulation (EU) No 575/2013 of the European Parliament and of the Council
DoD	Definition of Default
EBA	European Banking Authority
ECL	Expected Credit Loss
ESEP	European Supervisory Examination Programme
IFRS	International Financial Reporting Standard
IRB	Internal Ratings-Based
LCR	Liquidity Coverage Ratio
OCR	Overall Capital Requirement
P2G	Pillar II guidance
P2R	Pillar II requirements
PD	Probability of Default
PGS	Public Guarantee Schemes
RWEA	Risk-weighted Exposure Amounts
SICR	Significant Increase in Credit Risk
SREP	Supervisory Review and Evaluation Process
SSM	Single Supervisory Mechanism
UTP	Unlikeliness To Pay

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Executive summary

1. The unprecedented Covid-19 pandemic triggered containment measures that put large parts of the economy to a halt and created significant challenges for society. Against this backdrop, ample immediate support was provided, including to the EU banking sector, where policy actions were promptly taken to mitigate the impact of the pandemic, notably with the swift publication in April 2020 of the EBA Guidelines on the prudential treatment of general payment moratoria, which prevented automatic classification into forbearance. The first chapter of the report provides an overview of the wide range of policy measures taken on the back of the pandemic, followed by a second chapter on policy implementation issues recently raised in the context of these measures.

2. In the first stage of the pandemic, policy support was essential to address the short-term liquidity challenges triggered by the health emergency situation, and shielded firms and individuals for which temporary income losses were unrelated to their longer-term viability. However, policy assistance was to evolve to avoid distorting true identification of risk that could ultimately hinder adequate bank capitalization, and the associated risks to the real economy. The exceptional policy measures were designed to be framed in a context of short-term liquidity shortages driven by the pandemic, and hence, when the next stage of the pandemic allowed, normalisation was sought, notably through the phase-out of the EBA Guidelines on general payment moratoria. The third chapter of this report presents the state of play of measures taken.

3. The weaning of policy support was coupled with recognition of the exceptional circumstances of the pandemic, which required continuous monitoring of the situation. This vigilant and flexible approach resulted for instance in the time-limited reactivation of the Guidelines on general payment moratoria to aid in the context of the second Covid-19 wave, followed by the subsequent fully phase-out of the Guidelines to avoid unduly distorting prudent recognition of losses.

4. The EBA has put in place a broad-range of measures to ensure efficient monitoring of the impact of Covid-19 and gauge the challenges posed to the banking sector in its path out of the pandemic. This encompasses supervisory, reporting and disclosure measures, as well as technical monitoring of prudential and accounting considerations triggered by the pandemic, notably around the classification of default. Further, the EBA has also issued guidance on data representativeness for the purposes of banks' internal modelling, and the tensions that might arise between figures collected at face value and the intertwined Covid-19 support measures. The fourth chapter of the report provides a picture of the path out of the support measures.

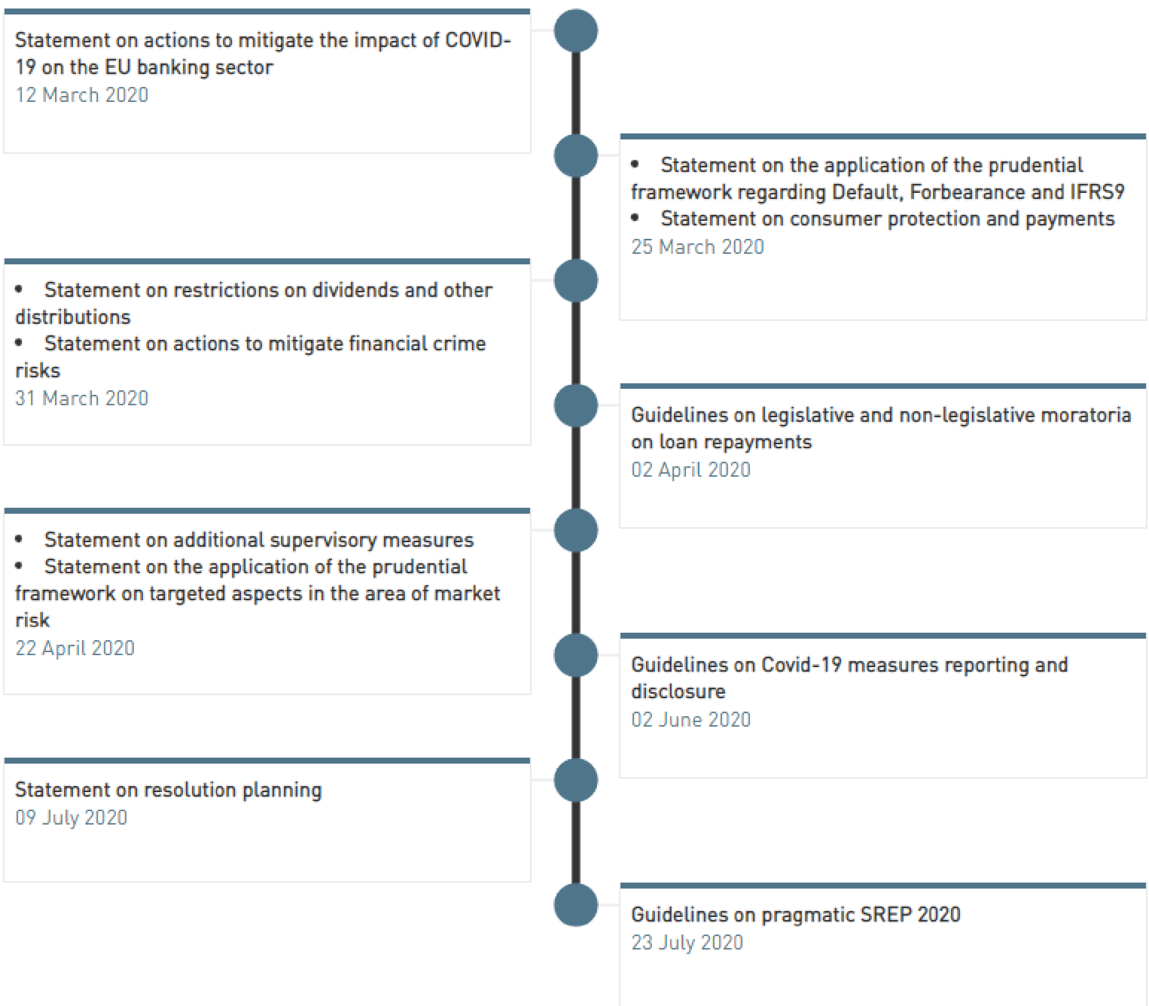
5. Meanwhile the Russian invasion of Ukraine and the uncertainties associated to the economic outlook result in new risks, albeit of a different nature than during the pandemic. While the Covid-19 crisis was associated primarily with liquidity challenges, the current juncture seems to raise concerns from a solvency angle, hence calling for a different approach. The final chapter of the report concludes highlighting the need to accomplish the transition out of Covid-19 and notes the risks associated to an orderly phase-out.

1. Stock-take of support measures

6. Against the background of the measures taken by national governments and at EU level to address and mitigate the adverse systemic economic impact triggered by Covid-19 on the EU banking sector, the EBA has provided clarity to banks and consumers on the application of prudential and supervisory measures to support lending into the real economy, together with alleviating the operational burden on banks where possible, whilst maintaining high standards of conduct, consumer protection and measures to tackle financial crime.

7. This section takes stock of the measures taken, while observations on the state of play and weaning of measures is discussed in chapters 3 and 4.

Figure 1: Key EBA actions in light of Covid-19



Note: The full timeline of EBA actions can be found in the Annex, as well as on the EBA website.

1.1 Regulatory measures

8. Following the outbreak of the Covid crisis, the EBA took swift action to clarify a number of aspects on the functioning of the prudential framework, with the aim to provide clarity to the EU banking sector on how to handle in a consistent manner, aspects related to (i) the classification of loans in default, (ii) the identification of forborne exposures and (iii) the accounting treatment, as summarised in its Statement on the application of the prudential framework regarding Default, Forbearance and IFRS9 in light of Covid-19 measures of 25 March 2020[1].

9. This was followed shortly afterwards by more detailed guidance on the criteria to be fulfilled by legislative and non-legislative moratoria, which if fulfilled, helped to avoid the classification of exposures subject to a moratorium under the definition of forbearance or as defaulted under distressed restructuring.

1.1.1 Guidelines on legislative and non-legislative moratoria on loan repayments

10. The EBA published on 2 April 2020 the Guidelines on legislative and non-legislative moratoria on loan repayments (EBA/GL/2020/02)[2] whereby conditions were provided under which exposures covered by the moratoria should not necessarily be classified as forborne under Article 47b of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR) and, consequently, would not have to be automatically assessed as distressed restructuring under the definition of default.

11. The Guidelines on moratoria allowed institutions to grant payment holidays for a pre-defined set of obligors, for which there needed not be an automatic regulatory reclassification, due to the Covid-19 crisis. However, while the application of the Guidelines removed the obligation to perform an automatic reclassification when granting payment holidays under a broad moratorium, it did not remove the responsibility of institutions to continue loan monitoring and ensure that credit issues, both in the prudential, but also accounting framework, were recognised.

12. The Guidelines were originally scheduled to cover moratoria applied before 30 June 2020 and were subsequently first extended until 30 September 2020[3], and then eventually until 31 March 2021[4]. A vigilant and flexible approach remained in place, which resulted in the time-limited reactivation of the Guidelines to aid in the context of the second Covid-19 wave, followed by the subsequent fully phase-out of the Guidelines to avoid unduly distorting prudent recognition of losses[5].

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[1] Statement on the application of the prudential framework regarding Default, Forbearance and IFRS9 in light of COVID-19 measures.pdf (europa.eu)

[2] EBA-GL-2020-02 Guidelines on payment moratoria.pdf (europa.eu)

[3] EBA extends deadline for the application of its Guidelines on payment moratoria to 30 September | European Banking Authority (europa.eu)

[4] The EBA reactivates its Guidelines on legislative and non-legislative moratoria | European Banking Authority (europa.eu)

[5] Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis | European Banking Authority (europa.eu)

13.This report is accompanied by an update on the list of Public Guarantee Schemes issued in response to the Covid-19 pandemic and General Payment Moratoria.

1.1.2 Guidelines on reporting and disclosure of exposures in response to Covid-19

14.On the back of ensuring effective monitoring of the application of the moratoria on loan repayments, Covid-19-related forbearance measures and the use of public guarantees, the EBA introduced as an exceptional and temporary measure the Guidelines on reporting and disclosure of exposures subject to measures applied in response to the Covid-19 crisis (EBA/GL/2020/07)[6], which were published on 2 June 2020.

15.The Guidelines addressed data gaps associated with such measures to ensure an appropriate understanding of institutions' risk profile and the asset quality on their balance sheets for both supervisors and the wider public. General trends on moratoria and PGS based on these Guidelines are discussed in section 3.1 of this report.

16.This temporary Covid-19 reporting and disclosure framework was originally meant to be in place for 18 months, but on 17 January 2022 the EBA confirmed the continued application of Covid-19 reporting and disclosure requirements for another year, to ensure monitoring of exposures and the credit quality of loans with public support measures in those Member States, where those were still relevant. Given the decreasing relevance of Covid-19-related public support measures in the current Covid-19-related context, and in line with the EBA proportionate approach to reporting, the EBA decided to subsequently repeal the Guidelines on Covid-19 reporting and disclosure from 1 January 2023.

1.1.3 Targeted aspects in the area of market risk

17.The EBA proposed temporary amendments to the RTS on prudent valuation[7] and the postponement of the final two implementation phases of the margin requirements for non-centrally cleared derivatives, which required changes to the JC RTS[8]. This was complemented by temporary operational relief measures such as the FRTB-SA reporting requirement under the CRR2.

1.2 Supervisory measures

18.At the onset of the pandemic the EBA, in close co-ordination with Competent Authorities (CAs), promptly communicated that the full flexibility embedded in the regulatory framework was

[6] EBA issues Guidelines to address gaps in reporting data and public information in the context of COVID-19 | European Banking Authority (europa.eu)

[7] EBA-RTS-2020-04 Amending RTS on Prudent Valuation.pdf (europa.eu)

[8] Joint RTS on amendments to the bilateral margin requirements under EMIR in response to the COVID-19 outbreak.pdf (europa.eu)

available to be used on the back of the Covid-19 crisis[9]. This section lists the relevant supervisory measures taken, while observations on their use and phase-out is discussed in section 4.1.

1.2.1 Flexibility around buffer release, Pillar II guidance, Pillar II requirements covered with instruments other than CET1 and the LCR

19. In a statement issued on 12 March 2020[6] the EBA encouraged competent authorities, where appropriate, to make full use of the flexibility already embedded in the existing regulatory framework, noting:

- Provisions in the regulatory framework ensure that banks build up adequate capital and liquidity buffers. These buffers, including macroprudential ones, are designed to be used in order to absorb losses and ensure continued lending to the economy during a downturn.
- The ECB-Banking Supervision's decision to allow banks to cover Pillar 2 requirements with capital instruments other than Common Equity Tier 1 (CET1)[10]. This decision brings forward a provision under the Capital Requirements Directive V (CRDV), which was set to come into effect in January 2021.
- The use of Pillar 2 Guidance to ensure that prudential regulation is countercyclical and banks can provide the necessary support to the household and corporate sectors.
- The Liquidity Coverage Ratio (LCR) is designed to be used under stress. Supervisors should avoid any measures that may lead to the fragmentation of funding markets

1.2.2 Restrictions on dividends and other distributions

20. On 31 March 2020[11] the EBA issued a statement to refrain from dividend distribution and share buybacks that result in a capital distribution outside of the banking system to maintain robust capitalisation. Remuneration and, in particular, its variable portion were expected to be set at a conservative level, consistent with the economic situation and to ensure sound and effective risk management

1.2.3 Market risk clarifications

21. Against a background of extreme volatility at the onset of the pandemic, the EBA issued in April 2020 clarifications around the treatment of backtesting overshootings due to the increase in the Value-at-Risk (VaR) risk metrics, the computation of the multiplication factors under the Internal Models Approach (IMA) for market risk, and the review of the SVaR observation period[12].

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[9] EBA Statement on Coronavirus - 12 March 2020

[10] ECB Banking Supervision provides temporary capital and operational relief in reaction to coronavirus (europa.eu)

[11] Statement on dividends distribution, share buybacks and variable remuneration.pdf (europa.eu)

[12] EBA Statement on the application of the prudential framework on targeted aspects in the area of market risk in the COVID-19.pdf (europa.eu)

1.2.4 Pragmatic SREP 2020

22. The EBA published in July 2020 Guidelines on a pragmatic and flexible approach to the 2020 SREP Guidelines[13], which identify how flexibility and pragmatism could be exercised in relation to the SREP framework in the context of the Covid-19 pandemic.

1.2.5 Resolution planning

23. On 22 April 2020[14], the EBA issued a recommendation recognising the need for credit institutions to maintain a strong focus on effective crisis management and preparedness in the context of Covid-19, where recovery plans should be kept reviewed and updated in order to be implemented timely and effectively if needed. Further, on 9 July 2020 the EBA re-affirmed the crucial role of resolution planning in time of uncertainty to ensure that resolution is a credible option in case of failure, with a view to ensure that the pandemic situation was effectively taken into account by resolution authorities. This includes ensuring resolution plans and MREL decisions are up-to-date.

1.3 Measures to protect customers, ensure orderly functioning of payment services, tackle financial crime and ensure digital operational resilience

24. The EBA issued a statement on 25 March 2020 to call for financial institutions to ensure the interest of consumers is protected with regards to application of Covid-19 support measures[15], notably with respect to the importance of full disclosure of potential charges and costs, the transparency and clarity of the terms and conditions, as well as avoiding automatism in the consumer's rating in the context of general payment moratoria.

25. Regarding the interaction between the spread of Covid-19 and the orderly functioning of payment services across the EU, contactless or remote payments were encouraged as a sanitary precaution together with measures to facilitate making contactless payments by making use of the existing exemptions from strong customer authentication and increasing its threshold.

26. Further, the EBA called on 31 March 2020[16] on competent authorities to support that effective systems and controls continue to be put in place to ensure that the EU's financial system is not abused for money laundering or terrorist financing (ML/TF) purposes, as well remaining alert for identifying new related risks, while noting the flexibility embedded in the EU's AML/CFT framework to plan related supervisory activities in a pragmatic and risk-sensitive way in line with the ESA's ' Guidelines on Risk Based AML/CFT Supervision[17].

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[13] EBA publishes Guidelines on a pragmatic and flexible approach to the 2020 supervisory review and evaluation process in light of the COVID-19 pandemic | European Banking Authority (europa.eu)

[14] EBA statement on additional supervisory measures in the COVID-19 pandemic.pdf (europa.eu)

[15] Statement on consumer protection and payments in the COVID19 crisis.pdf (europa.eu)

[16] Statement on actions to mitigate financial crime risks in the COVID-19 pandemic.pdf (europa.eu)

[17] Guidelines on risk based supervision | European Banking Authority (europa.eu)

27. Finally on 22 April 2020 the EBA emphasized the importance of digital operational resilience[18], calling on institutions to ensure business continuity, adequate ICT capacity and security risk management.

1.4 Operational relief measures

28. To support banks to focus on core operations, the EBA announced on 12 March 2020[19]:

- The postponement of the EU-wide stress test exercise to 2021 to allow banks to focus on and ensure continuity of their core operations, including support for their customers.
- A recommendation for Competent Authorities (CAs) to plan supervisory activities, including on-site inspections, in a pragmatic and flexible way, and possibly postpone those deemed non-essential.
- The possibility for CAs to give banks some leeway in the remittance dates for some areas of supervisory reporting, without putting at stake the crucial information needed to monitor closely banks' financial and prudential situation. Specific clarifications followed in the EBA statement of 31 March 2020[20]

29. Further, the EBA announced on 25 March 2020[21] the following adjustment to EBA activities to limit any non-essential requests in the short-term:

- To extend the deadlines of ongoing public consultations by two months
- To postpone all public hearings already scheduled to a later date and run them remotely via teleconference or similar means
- To extend the remittance date for funding plans data
- In coordination with the Banking Committee on Banking Supervision to extend the remittance date for the Quantitative Impact Studies based on December 2019 data.

30. Finally, on 31 March 2020 the EBA called for CAs to be flexible when assessing the institutions' compliance with the deadlines for the publication of their Pillar 3 reports as set out in accordance with Article 106 (1) CRD, and emphasized that CAs and institutions should assess the need for additional Pillar 3 disclosures on prudential information that may be necessary in order to properly convey the risk profile of the institutions in the context of the Covid-19 outbreak.

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[18] EBA provides further guidance on the use of flexibility in relation to COVID-19 and calls for heightened attention to risks | European Banking Authority (europa.eu)

[19] EBA Statement on Coronavirus.pdf (europa.eu)

[20] Statement on supervisory reporting and Pillar 3 disclosures in light of COVID-19.pdf (europa.eu)

[21] Further actions to support banks' focus on key operations - postponed EBA activities.pdf (europa.eu)

2. Implementation issues related to EBA Covid-19 measures

31. The implementation of EBA policies related to Covid-19 has given rise to policy issues, which have been discussed and clarified through the publication of EBA Reports on the implementation of selected Covid-19 policies, which were published on 7 July 2020[22], 21 December 2020[23] and 29 January 2021[24]. This section discusses two additional issues that have subsequently been identified, related to 1) the definition of forbearance in the context of legislative moratoria and 2) Restructuring of PGS loans issued in response to Covid-19.

2.1 Definition of forbearance in the context of legislative moratoria

32. On the back of the short-term liquidity challenges triggered by the Covid-19 pandemic, the EBA Guidelines on legislative and non-legislative moratoria (the Guidelines) specified the criteria under which the application of eligible general payment moratoria to exposures would not automatically trigger forbearance classification of such exposures. This measure was designed to be time-limited to ensure that, while lending to the economy would be facilitated, sound risk identification of longer-term solvency issues would be preserved.

33. An additional implementation question related to the Guidelines has been identified since the last EBA report on the implementation of Covid-19 policies was produced. The issue addresses if the application of legislative moratoria falls within the definition of forbearance.

Relevant characteristics of legislative moratoria

34. As a general remark, the following characteristics of legislative moratoria are noted:

- A legislative moratorium refers to a moratorium based on the applicable national law, as noted in point a of paragraph 10 in the Guidelines
- Not all legislative moratoria are by definition compulsory (in the sense that institutions are obliged to offer them to obligors). Instead, legislative moratoria can be both compulsory and optional.
- Should institutions compulsorily offer the legislative moratorium to obligors, obligors have the right to reject the offer, and resume the originally agreed payment schedule.

[22] Report on implementation of selected COVID-19 policies - 7 July 2020
[23] EBA Report on implementation of COVID-19 policies - 21 December 2020
[24] EBA Report on the implementation of selected COVID-19 policies - 29 January 2021

Criteria for forbearance classification

35. Forbearance measures are defined in Article 47b(1) of the CRR. Further, the Guidelines introduced an exception in the forbearance classification for a time-limited period, whereby exposures subject to payment moratoria that met the conditions specified in paragraphs 10 and 10(bis) of the Guidelines were not automatically considered as forborne, and the treatment set out in paragraphs 11 to 16 of the Guidelines would apply.

36. If during the period of application of the Guidelines one of the conditions in paragraph 10 or 10(bis) of the Guidelines was not met, then institutions should have assessed for each exposure covered by the legislative moratorium whether forbearance based on the definition set out in Article 47b(1) of the CRR was met.

Interaction Article 47b(1)(a) and legislative moratoria

37. During the period of application of the Guidelines, where a legislative moratorium did not meet all the conditions specified in the Guidelines, the definition of forbearance measures set out in Article 47b should be assessed. Article 47b(1) of the CRR specifies that forbearance measure is a concession by an institution towards an obligor that is experiencing or is likely to experience difficulties in meeting its financial commitments.

38. On the one hand, it could be argued that an assessment should be performed by the institution on the obligor experiencing or likely to experience difficulties in meeting its financial commitments, and if so, classify the exposure under legislative moratorium as forborne.

39. Under this interpretation a legislative moratorium meets the condition under Article 47b(1)(a) of the CRR when:

- The obligor accepts the legislative moratorium that is offered to him by its institution; and
- The institution has made an individual assessment of the exposure and concludes that the obligor is experiencing or is likely to experience difficulties in meeting its financial commitments.

40. On the other hand, it could be argued that the reference in Article 47b(1)(a) of the CRR that a concession refers to a “modification of the terms and conditions of a debt obligation, where such modification would not have been granted had the obligor not experienced difficulties in meeting its financial commitments” would entail a choice not to grant a modification to the obligor, while a legislative moratorium implies a modification of the contractual terms of a debt obligation, irrespective of whether it is compulsory or not.

41. Under this interpretation, on the basis that the modification has been granted to all obligors without discrimination, the modification could have also been granted if the obligor had not experienced difficulties in meeting its financial commitments, and therefore the conditions under article 47b would not be met.

42. In line with paragraph 14 of the Guidelines on legislative and non-legislative moratoria, this would not remove the obligation for institutions to continue assessing the potential unlikeliness to pay of obligors, in accordance with policies and practices that institutions usually apply to such assessments.

2.2 Restructuring of PGS loans issued in response to Covid-19

Introduction

43. Public Guarantee Schemes (PGS) were part of the toolkit of response measures adopted by Member States to mitigate the effect of Covid-19, by way of facilitating the flow of credit to the economy and alleviate the impact of the pandemic. From the prudential standpoint, when the provision of those public guarantees qualified as Credit Risk Mitigation (CRM) under the Capital Requirements Regulation, the associated reduction in risk-weighted exposure amounts incentivised lending institutions to grant credit.

44. PGS represent a form of state funding to be notified to the Commission to prevent an adverse impact on competition and trade in the internal market of the European Union[25]. Against the background of the Covid-19 pandemic the European Commission adopted on 19 March 2020 a Temporary Framework for State aid measures to support the economy in the context of the pandemic (the Temporary Framework)[26] to ensure a close European coordination of national aid measures aimed at ensuring liquidity and access to finance, while ensuring a level playing field.

45. The sixth amendment to the Temporary Framework issued in November 2021 includes the possibility of extending the duration of the PGS, subject to conditions, including that "the terms and conditions of such an extension should be stipulated in the initial guarantee contracts between the State and the credit financial institution" and that "credit or financial institutions may accept or refuse the request in accordance with their standard policies and procedures"[27].

46. The Temporary Framework was phased out on 30 June 2022, while noting that after this date Member States may still be allowed to restructure PGS loans under certain conditions[28].

47. This section discusses the prudential implications of the potential maturity restructuring of loans secured by PGS offered in response to the pandemic on the Unlikeliness To Pay (UTP) assessment. This section does not represent any view on specific Member State measures.

[25] Small amounts of State aid are exempted from notification as per Regulation (EU) No 1407/2013 on de minimis aid https://eur-lex.europa.eu/EN/legal-content/summary/de-minimis-rule-exemption-of-small-amounts-of-state-aid-from-notification.html

[26] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ%3AJOC_2020_091_I_0001

[27] See recital 12 in https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ%3AJOC_2021_473_R_0001&qid=1637742014803

[28] Non-paper on restructuring possibilities post June 2022_final.docx (europa.eu)

Prudential assessment of Unlikeliness To Pay

48. Any form of credit risk mitigation such as guarantees provided by third parties to institutions should not exempt institutions from assessing the potential unlikeliness to pay of the obligor or affect the results of such an assessment.

49. An extension of the PGS maturity that results in a change of maturity of the associated loan represents a change in its terms and conditions, which triggers an assessment of forbearance as set out in Article 47b of the CRR. Institutions should assess whether Article 47b, paragraph 1 of the CRR is met, and in particular if a concession refers to "a modification of the terms and conditions of a debt obligation, where such modification would not have been granted had the obligor not experienced difficulties in meeting its financial commitments".

50. Forbearance measures which constitute a distressed restructuring in the sense of Article 178(3)(d) of the CRR should be assessed to decide whether the obligor should be classified as defaulted. To this end, institutions are required to assess whether these measures either likely led to a diminished financial obligation, as further clarified in paragraphs 50 to 52 of the EBA Guidelines on the application of the definition of default, or another possible UTP indicator is triggered as detailed in paragraph 53 of the aforementioned Guidelines. The assessment of forbearance is to be performed by institutions on a case-by-case basis according to the existing regulation and the policies and practices that lending institutions apply to such assessments.

51. When a large number of obligors is required to be assessed, it is expected that institutions will apply these policies in a risk-based manner, paying particular attention to and prioritising the assessment of those obligors who are most likely to experience payment difficulties. An institution with permission to use the IRB approach could use its estimates of the probability of default for the priorisation of the obligors. Otherwise, an institution could use the results of its internal risk classification systems for this purpose.

Issuance of PGS loans in response of events other than Covid-19

52. The Commission adopted in March 2022 a Temporary Crisis Framework providing Member States with the flexibility to use State aid rules to address Russia's invasion of Ukraine[29], subsequently amended to account for the effect of increased energy prices[30].

53. Any change in existing loans terms and conditions should be addressed on a case-by-case basis according to the existing regulation and the policies and practices that lending institutions apply to such assessments.

[29] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.CI.2022.131.01.0001.01.ENG

[30] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02022XC0324%2810%29-20220720

3. State of play

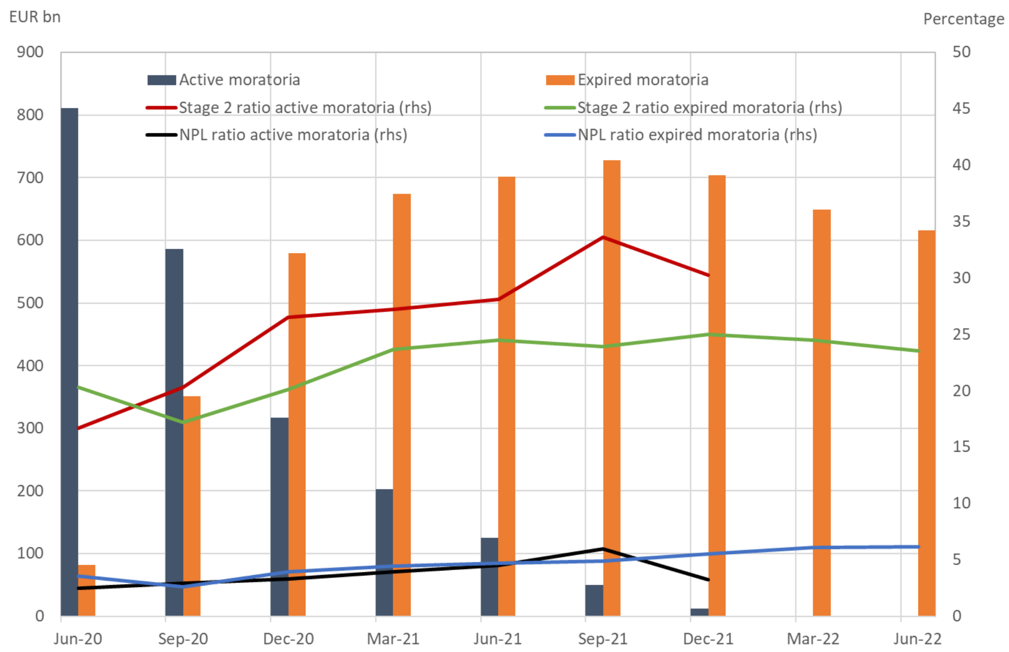
3.1 Trends in general moratoria and PGS exposures

3.1.1 General moratoria on loan repayments

54. The regulatory flexibility provided for the treatment of exposures with Covid-19-related forbearance measures was used extensively by banks across Europe. Within this framework, lenders provided short periods of payment holidays (or moratoria on loan repayments), which were instrumental in protecting borrowers from liquidity shortages or other short-term adverse effects of the pandemic.

55. Shortly after their broad rollout, there was a sharp increase in the take-up of EBA eligible moratoria to more than EUR 800bn, which represented approximately 6.5% of the total loans towards households and NFCs. However, a quick run-off followed, confirming the scope and use of the measure was of a temporary nature to address short-term liquidity problems caused by the pandemic. By the end of 2021, active moratoria had nearly completely run-off. As loan repayments resumed, banks' exposures towards loans with expired moratoria also started diminishing.

Figure 2: Trends in loans under moratoria



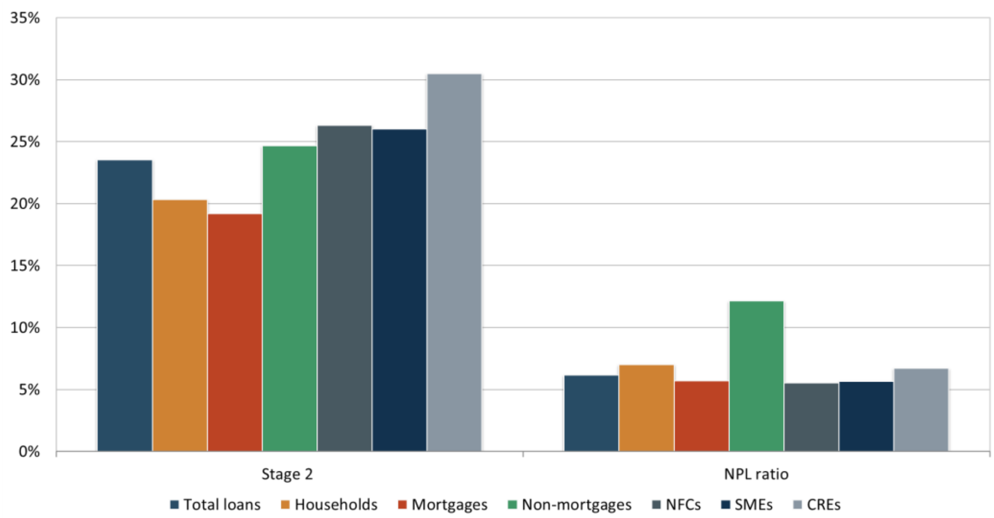
Note: Data collected on moratoria may not be directly comparable across time given potential changes in sample size, as competent authorities may exercise the flexibility provided in the EBA Guidelines on reporting and disclosures to reduce or stop some specific reporting and disclosure requriements.

Source: EBA Supervisory data.

56.As moratoria were presumably primarily used by those borrowers most hit by the pandemic, loans that benefited from moratoria have performed worse than loans on average. For loans under active moratoria banks quickly recognised the deterioration in their asset quality, classifying 16.7% in Stage 2 already in Q2 2020. This compares with a Stage 2 ratio for total loans of 8.2% at that time. The Stage 2 ratio has constantly grown thereafter to more than 30% (peak of 33.6% in Q3 2021 and 30.3% in Q4 2021 when relevant data was fully available). Loans with expired moratoria still have a substantially higher Stage 2 allocation compared to all loans. (23.6% vs 9.5% in Q2 2022). NPL ratios for loans under active and expired moratoria reached levels well above the overall average NPL ratio (which was 1.8% in Q2 2022). The ratio stood at 3.3% for loans under active moratoria in Q4 2021 (after a peak of 6% in the previous quarter) and 6.2% for loans under expired moratoria in Q2 2022.

57.Although asset quality had broadly deteriorated across all segments for loans that benefited from moratoria, banks recognised that commercial real estate (CRE) exposures with expired moratoria bore elevated risk. Banks classified more than 30% of their CRE loans in Stage 2. This may be also due to the structural changes seen for this segment. However, the highest NPL ratio was reported for household loans (excluding mortgages). In Q2 2022, banks reported more than EUR 55 billion of household loans that were not collateralized by residential immovable property, of which 12% were NPLs, please see Figure 3.

Figure 3: Asset quality indicators by sector



Source: EBA Supervisory data as of 2022Q2.

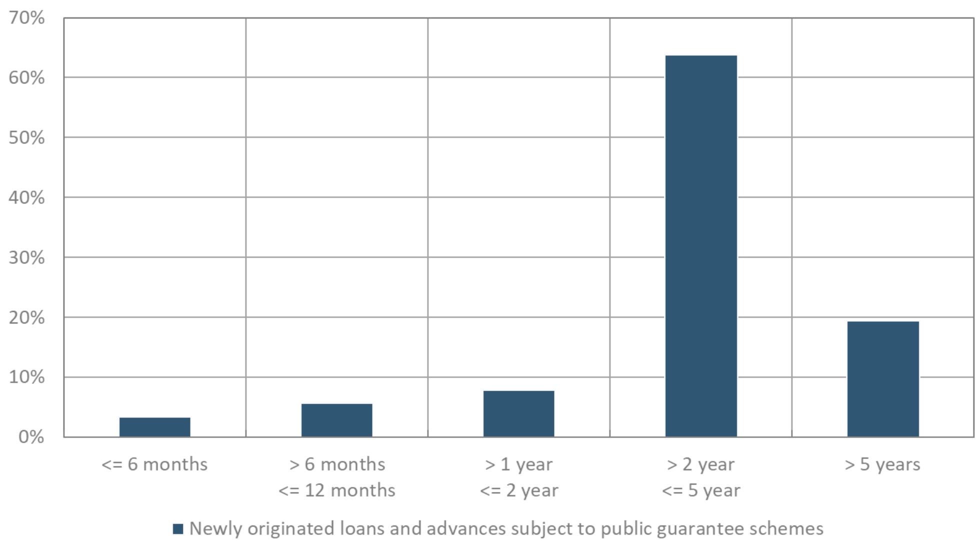
58.Although country dispersion on the use of moratoria was wide, as some economies rely more on Covid-19 hit industries, there was little dispersion across countries on the deterioration of asset quality of these loans. Borrowers in countries like Portugal and Cyprus or in Central Eastern Europe, like Hungary, made particular use of this Covid-19-support measure. Nevertheless, despite the increased use of these measures in these jurisdictions, there are no signs of major differences in asset quality metrics.

59.These trends clearly show that loans making use of loan repayment moratoria have been of lower asset quality. Although asset quality seems to have stabilised for loans with expired moratoria, the asset quality picture of these loans coupled with a blurred macroeconomic outlook, the ongoing geopolitical uncertainty, and the energy crisis calls for further close monitoring. Post-Covid-19 vulnerabilities for these borrowers may impair their repayment capacity in a worsening macroeconomic environment and could induce an increase in default rates. In view of the heightened share of loans under Stage 2, there is no room for complacency as some of these loans may still further deteriorate and move to Stage 3.

3.1.2 Public Guarantee Schemes

60.Loans subject to PGS have been increasingly provided since the outbreak of the pandemic. Starting from EUR 184bn in Q2 2020, they reached their peak of EUR 378bn in Q3 2021 and have since then been on a slight decline (EUR 365.1 billion in Q2 2022). Given the long maturities of some of these guarantees a substantial part of these exposures will presumably be on banks' balance sheets for several years to come. The biggest share has a maturity of 2 to 5 years as of Q2 2022 (64%), and 19% an even longer maturity, please refer to Figure 4.

Figure 4: Maturity profile of public guaranteed schemes

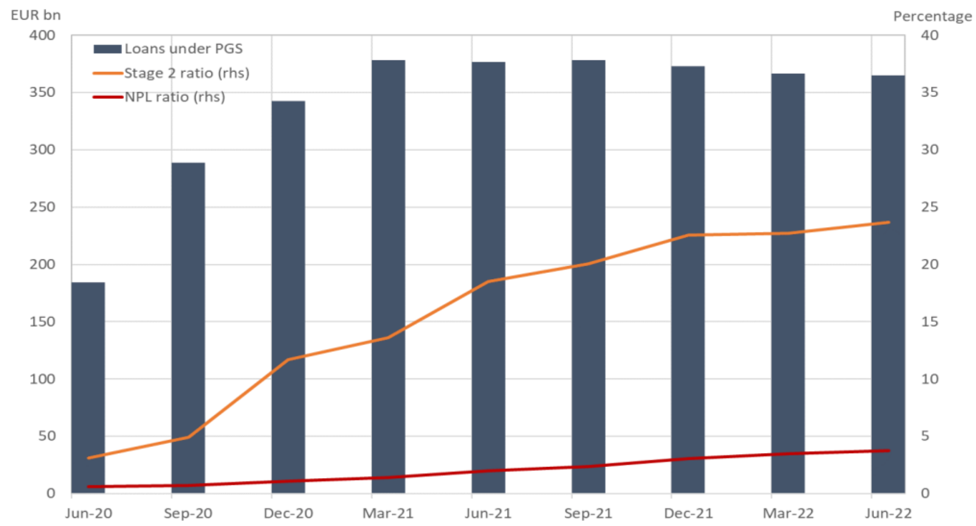


Source: EBA Supervisory data as of Q2 2022.

61.Similar to loans under moratoria, banks reported an increasingly deteriorating asset quality for loans subject to PGS. This might not least be explained by the fact that they were presumably prominently used by those sectors which have suffered most from the pandemic, such as hospitality.

62.The Stage 2 ratio rose from 3.1% in Q2 2020 to 23.7% in Q2 2022, similar levels like the Stage 2 ratio of loans under expired moratoria. The share of Stage 2 loans has stabilised in the last quarter. In contrast, the NPL ratio continues its rising trend, albeit at slower pace, from 0.6% in Q2 2020 to 3.7% in Q2 2022.

Figure 5: Trends in loans under Public Guarantee Schemes



Source: EBA Supervisory data.

63. These figures indicate that PGS loans tend to be of lower asset quality that banks' broad average exposures. However, around 76.6% of the PGS loans are guaranteed by their respective sovereigns, which would presumably soften any profit and loss impact for the banks in case of default.

64. Although loans subject to PGS were available across the EU, they were mostly provided by banks in a few countries like France, Italy and Spain. Banks in these three countries provided more than 95% of the total loans subject to PGS. The share of NPLs to total PGS loans reported by French and Spanish banks was higher than 5%, while for Italian banks it reached 1.1%.

3.2 Observations on current implementation of IFRS9 in the context of Covid-19

65. In line with the statement published on 25 March 2020[31], the EBA continued monitoring the EU institutions' accounting practices in the context of the Covid-19 pandemic to better understand the impact of IFRS 9 requirements on the regulatory capital position. Understanding how banks apply judgment in assessing and measuring credit risk for accounting purposes is of utmost importance from a regulatory and supervisory perspective. Detailed information on the latest EBA conclusions in the context of the IFRS 9 monitoring activities can be found in the EBA IFRS 9 implementation report published in November 2021[32] (the IFRS9 monitoring report). In the next paragraphs, some of the main highlights from this report are recalled.

[31] EBA Statement 25 March 2020

[32] EBA IFRS 9 report November 2021

66. All the observations from the regular EBA monitoring activities are meant to assist supervisors' evaluation of the quality and consistency of the Expected Credit Losses (ECL) frameworks implemented by EU banks, with a view to contribute to a high-quality and consistent application of the IFRS 9 standard, also in the context of stressed circumstances. As concluded in the IFRS9 monitoring report, banks have generally made significant efforts to implement the IFRS 9 standards and adapt their systems to meet the requirements. A wide variety of practices were observed, in line with the principle-based nature of the accounting standard, and no single practice appeared to be a strong driver of the ultimate levels of provisioning.

67. As regards the staging assessment and the significant increase in credit risk (SICR) assessment, which will lead to the recognition of lifetime ECL instead of 12-month ECL for instruments identified as having experienced SICR, limited changes were observed in banks' approaches during the first half of 2020. This was, in a way, surprising but it was also acknowledged that banks had limited time from the outbreak of the pandemic until June 2020 to adapt all the practices and tools previously and recently implemented[33]. Still, this observation triggered higher regulatory / supervisory attention to the methodologies in place and some expectations on how they would be expected to evolve in the short-term.

68. The use of a SICR collective assessment or any other similar approach to timely capture factors that would not be identified at an individual level remained very limited as of June 2020. This type of approaches, on top of the individual assessment, can lead to relevant impacts in terms of transfers to Stage 2 (lifetime ECL recognition) and it is expected to be used especially under a scenario where little information is available at individual level. For the analysed sample of banks, indeed, institutions using SICR collective assessment or any other type of similar approach have reported higher level of transfers during the periods under analysis.

69. In overall terms, the impact on the final ECL amount produced by the Covid-19 crisis has shown significant divergence across institutions. The IFRS 9 PD generally increased during the first half of 2020 as well as its variability as a result of the more point-in-time nature of the IFRS 9 PD and the incorporation of the forward-looking information (FLI) linked to the negative Covid outlook.

70. Unsurprisingly, the majority of the institutions changed the range of the IFRS 9 scenarios and/or their probability weights, generally introducing additional and more pessimistic scenarios or assigning a higher probability weight to thel downward scenario. However, the impact on ECL stemming from the incorporation of FLI, while increased compared to pre-Covid situation, varied significantly across the banks in the sample.

71. Nonetheless, despite the changes introduced, the IFRS 9 PD estimates were still significantly driven by the assumptions underlying the baseline scenario, raising concerns on the limited degree of the impact from the non-linearity in the multiple macroeconomic scenarios embedded in banks' models. Furthermore, it was noted that some banks have introduced certain practices aimed at avoiding excessive variability in the IFRS 9 estimates, or to minimize the impact on the

[33] To recall, the first application of IFRS 9 occurred for the majority of banks as of January 2018.

ECL measurement. Some examples of concerning practices observed were related to the smoothening of the relevant IFRS 9 macroeconomic variables (to reflect their average forecast), the reliance on pre- Covid-19 forecasts, countercyclical changes in the severity of the downward scenarios and changes in of the weight or the number of the multiple scenarios to reduce the impact of worst one.

72. Covid-19 pushed IFRS 9 models outside their boundaries, thereby increasing the use of overlays leading to more divergence in terms of materiality of the impact in the final ECL amount. In the context of the EBA monitoring activities on IFRS 9, it was observed that the provisioning coverage levels were higher for institutions making more use of overlays.

73. The application of temporary overlays is seen as necessary when models cannot cope with the specificities of a certain situation, as in the Covid-19 crisis. It is paramount that these overlays are associated with appropriate governance measures and controls. In addition, supervisors should be able to have a good understanding of the methodological features underlying the design and application of overlays to ensure that the credit risk is being appropriately reflected in the final impairment metrics and, as such, leading to adequate levels of regulatory capital.

74. As part of the conclusions presented in the IFRS9 monitoring report, going forward, the use of overlays across EU institutions should be subject to close and continued monitoring, to investigate whether and to what extent banks would adjust their ECL models to incorporate the effects of overlays, or if some type of overlays would be kept more permanently, despite their initially expected temporary nature[34]. Overlays can lead to relevant impacts in terms of the final ECL number and, as such, should be seen as a key area for regulatory and supervisory monitoring and will continue to be further explored in the next phases of the EBA monitoring activities.

Technical monitoring DoD interpretation

75. Following the EBA Guidelines on ECL[35], an alignment of the Definition of Default (DoD) for accounting purposes with the prudential definition of default is expected from a supervisory perspective. An analysis was conducted for the purpose of the IFRS9 monitoring report, where it was observed as of December 2020 that, despite some differences between the non-performing loans concept, the prudential DoD and the concept of credit-impaired financial asset (Stage 3 under IFRS 9), in practice institutions tended to converge or try to achieve full alignment of the three definitions. These results continued to be observed when analysing the ratios of non-performing exposures allocated to Stage 3 within the regular monitoring of IFRS 9 indicators throughout 2021.

[34] To recall, the EBA Guidelines issued in May 2017 (link) state the following: "*Credit institutions should use temporary adjustments to an allowance only as an interim solution, in particular in transient circumstances or when there is insufficient time to appropriately incorporate relevant new information into the existing credit risk rating and modelling process, (…).*"

[35] EBA Guidelines on credit institutions' credit risk management practices and accounting for expected credit losses

4. Path out of Covid-19 measures

76.This chapter discusses the path out of the exceptional measures triggered by the Covid-19 pandemic in relation to the banking system. Beyond the phase-out of the EBA Guidelines on the prudential treatment of general payment moratoria as of 1 April 2021[36], this section discusses the weaning of supervisory measures taken, the use of the extended IFRS-9 transitional provisions introduced in the CRR Quick-Fix and the monitoring of accounting overlays. Finally, the chapter concludes with the EBA guidance on the use of Covid-19 impacted data for the purposes of internal risk-based models for capital requirements calculation.

4.1 Supervisory measures

77.This section provides observations on the use of various supervisory support measures granted on the back of Covid-19 pandemic and provides an overall picture on the phasing out of these measures.

78.The supervisory measures have now generally phased-out and pre-pandemic standards apply again. The vigilance, however, remains where public support measures are still currently in force and/or in the process of being phased out.

79.Most of the supervisory support measures concerning the buffers are in the process of being phased out and/or buffers are in the process of being rebuilt over the course of 2022-2023. Supervisory approaches to dividend distribution have returned to normal although setting expectations towards institutions to maintain a prudent approach in the application of distribution, share-buyback and remuneration policies.

4.1.1 Buffer release

80.The Covid-19 crisis increased the need to ensure that banks had sufficient usable capital to absorb losses or maintain lending to the economy. This usability of capital in the buffer framework had been lengthily discussed prior to the Covid-19 crisis[37]..

81.The EBA statement of 12 March 2020 on actions to mitigate the impact of Covid-19 on the EU banking sector reminded that capital and liquidity buffers are designed to be used for absorbing losses or maintaining lending and cushioning liquidity stress.

82.Along this general statement, the EBA supported actions by national authorities to release macroprudential buffers. The countercyclical capital buffer (CCyB) was by design one of the capital buffers that could be quickly released by national authorities in Europe, where a positive CCyB was in place. A release of the CCyB directly reduces banks' risk-weighted capital requirements and

[36] Please refer to section 1.1.1.

[37] See notably the "Newsletter on buffer usability" issued by the BCBS on 31 October 2019

hence provides directly available capital space to banks. The CCyB released between December 2019 and June 2021 amounted to EUR 17.6 bn or 20bps of EEA banks' total RWEA, but the available releasable buffer was very uneven across countries[38]. As of June 2022, 16 countries out of 30 had already implemented CCyB requirement or announced an increase of it for H2 2022 or 2023, please see Figure 6.

83. Several national authorities also released the systemic risk buffer (SyRB), either fully or partly. The release of the SyRB between December 2019 and June 2021 added another EUR 33.5 bn to the released capital, or 38bps of EEA banks' total RWA. As of June 2022, 15 countries out of 30 had implemented a sectoral (applied to a specific subset of exposures) or general SyRB (applied to all exposures).

Figure 6: Countercyclical capital buffers are coming back or exceeding pre-Covid levels

Countercyclical buffer rates set by designated authorities, by implementation date, in per cent

Country	2019	2020	2021	2022	2023
Austria	0	0	0	0	0
Belgium	0	0	0	0	0
Bulgaria	0.5	0.5	0.5	1	2
Croatia	0	0	0	0	1
Cyprus	0	0	0	0	0
Czech Republic	1.75	0.5	0.5	1.5	2.5
Denmark	1	0	0	2	2.5
Estonia	0	0	0	1	1.5
Finland	0	0	0	0	0
France	0.25	0	0	0	0.5
Germany	0	0	0	0	0.75
Greece	0	0	0	0	0
Hungary	0	0	0	0	0.5
Iceland	2	0	0	2	2
Ireland	1	0	0	0	1
Italy	0	0	0	0	0
Latvia	0	0	0	0	0
Liechtenstein	0	0	0	0	0
Lithuania	1	0	0	0	1
Luxembourg	0.25	0.25	0.5	0.5	0.5

[38] For further information please refer to the EBA advice on the review of the macroprudential framework.pdf (europa.eu)

Country	2019	2020	2021	2022	2023
Malta	0	0	0	0	0
Netherlands	0	0	0	0	1
Norway	2.5	1	1	2	3
Poland	0	0	0	0	0
Portugal	0	0	0	0	0
Romania	0	0	0	0.5	1
Slovakia	1.5	1	1	1	1.5
Slovenia	0	0	0	0	0
Spain	0	0	0	0	0
Sweden	2.5	0	0	1	2

Source: Figures based on ESRB data, compiled from national competent authorities, retrieved as of 28 November 2022. https://www.esrb.europa.eu/national_policy/ccb/html/index.en.html

Possibility to temporarily operate below CCB, P2G, LCR and leverage ratio

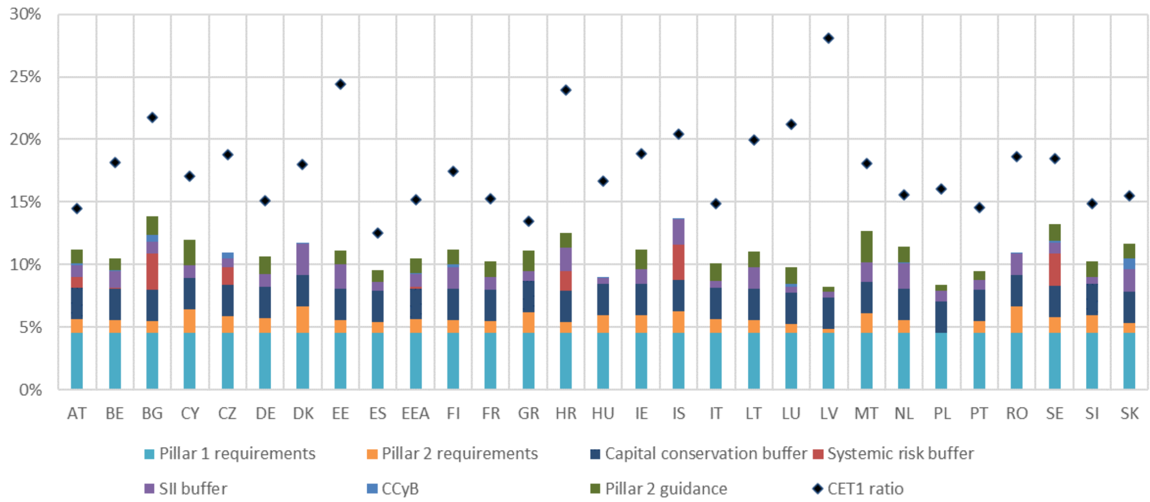
84. In March 2020, the ECB-SSM announced measures to provide temporary capital and operational relief to its directly supervised banks in the context of Covid-19[39], so that institutions were allowed to operate temporarily below the level of capital defined by the Capital Conservation Buffer (CCB) and LCR. The ECB-SSM also allowed the use of Additional Tier 1 and Tier 2 instruments to comply with Pillar 2 Requirements, and granted the possibility to temporarily exclude certain exposures to Eurosystem central banks from the calculation of the leverage ratio).

85. Further, the ECB-SSM allowed banks to operate temporarily below the level of capital defined by the Pillar 2 Guidance (P2G), which stands on top of capital buffers and indicates to banks the adequate level of capital to be maintained to hold sufficient capital as a buffer to withstand stressed situations. The EBA has observed that only a limited number of institutions actually held capital levels below P2G in 2020 and 2021. Most of these cases seem to refer to institutions facing structural issues that already existed before the pandemic.

86. Overall, the vast majority of institutions were not relying on this supervisory support measure, which however does not mean that the release had no impact, in particular in terms of setting expectations from the market. The possibility to operate below P2G will not go beyond the end of 2022.

[39] ECB Banking Supervision provides temporary capital and operational relief in reaction to coronavirus (europa.eu)

Figure 7: Buffers above Overall Capital Requirements



Note: Data as of 2022Q2.

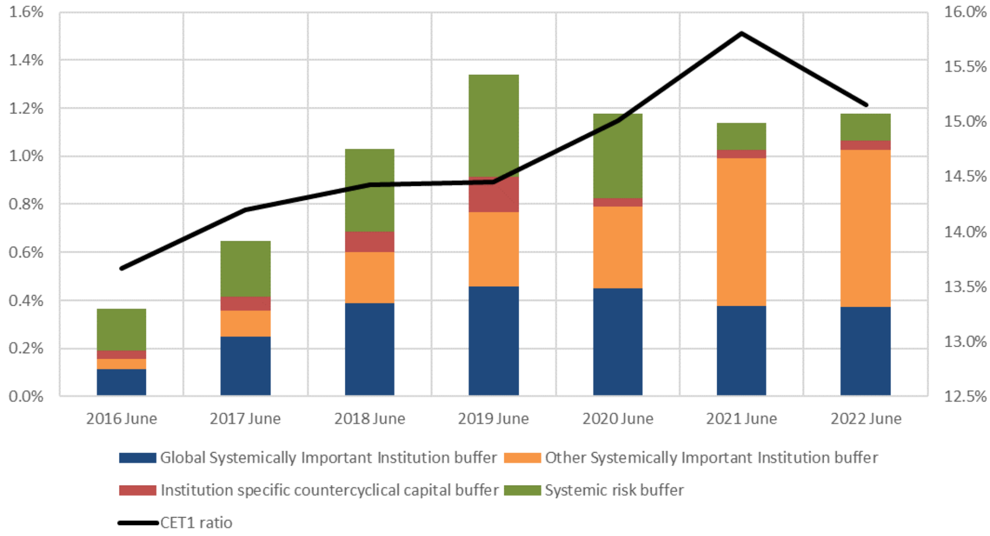
Source: EBA Supervisory Statistics.

87. Most capital relief measures initiated in 2020, including the buffer releases as well as the possibility to operate temporarily below OCR, were preserved over the course of 2021 to ensure an additional temporary solution for providing capital relief. Institutions generally did not need to make use of the released capital buffers, as the impact of the pandemic was cushioned by significant public support.

88. During 2020 and 2021, banks continued to meet the demand for loans and did not need to make use their capital buffers. In fact, banks increased the capital headroom above capital requirements since the start of the pandemic. In Q2 2022, driven by a surge in RWA and a slight decline in CET1 capital sources, the CET1 capital ratio decreased by 60bps compared with Q2 2021[40].

[40] https://www.eba.europa.eu/eba-risk-dashboard-shows-capital-ratios-remained-broadly-stable-and-liquidity-ratios-declined

Figure 8: Evolution of macroprudential buffers and CET1 ratio



Source: EBA Supervisory Statistics.

Phasing-out

89. Regarding buffer release measures, not all CAs expressed views on the phasing out. While some CAs already noted that a staged approach for the rebuild of the buffers has been initiated in their jurisdictions, other CAs informed that it is not possible anymore to operate below the OCR.

90. It will be important to rebuild the regulatory capital buffers to sufficient levels so that those buffers can be released when the next crisis occurs. This holds true particularly for the CCyB to strengthen its function and relevance as a cyclical buffer

91. Regarding LCR requirements, the ECB-SSM noted that the relief measures expired on 31 December 2021, while regarding the leverage ratio, the exclusion of the central bank exposures from leverage ratio was possible only until end-March 2022. Both decisions were also taken by most of the competent authorities of the Banking Union.

4.1.2 P2R-P2G determination and pragmatic SREP

92. As CAs implemented the Pragmatic SREP[41] in 2020, P2R-P2G levels were kept largely unchanged, unless exceptional circumstances justified any changes. The pragmatic SREP GLs envisaged a special procedure exclusively for 2020, with a return to a 'normal' SREP in the 2021 cycle. Based on the available data, the EBA noted lower average P2R in 2021 than in 2020.

[41] Guidelines on the pragmatic 2020 SREP in light of the COVID-19 crisis

93.CAs applied institution-specific considerations already in 2021, and methodologies for setting the P2R-P2G were not specifically impacted by the pandemic anymore. The 2021 SREP cycle already returned to normal and P2R and P2G were set based on idiosyncratic considerations. The shift back to normal nevertheless entailed ongoing vigilance on:

- Covid-19 implications on institutions` portfolios and in a broader sense on credit risk, in cases where the public support measures have not yet been completely phased out or are in the process (e.g. the effects of moratoria on credit risk.)
- Assessment with a Covid-19 outlook and in the context of any potential long-term implications of higher interest rates.

4.1.3 Dividend distribution, share buy-back and variable remuneration[42]

94.At the onset of the crisis CAs followed a conservative approach in line with the EBA statement to follow prudent dividend and other distribution policies, including variable remuneration and use capital for ensuring continuous financing to the economy. Banks were asked to review their remuneration policies, practices and awards to ensure that they were consistent with and promote sound and effective risk management also reflecting the pandemic.

95.The vast majority of banks across Europe adhered to supervisory recommendations and refrained from remunerating shareholders from 2019 profits[43]. While for previous years, banks' plans largely coincided with actual pay-outs, for dividends paid out in 2020, based on FY2019 profits, the gap between banks' plans and actual pay-outs was about EUR 29 bn or 35% of 2019 profits. CAs adjusted their recommendations to allow banks to distribute a limited share of their dividends from 2019-2020 profits in the first 9 months of 2021[44], nevertheless banks were expected to continue to apply conservative distribution policies.

96.The ESRB and ECB recommendation on restrictions of distributions lapsed end of September 2021[45], thus supervisors returned to the pre-pandemic way of assessing banks' capital and dividend plans. Nevertheless, institutions are expected to apply conservative dividend and remuneration policies, although there are no clear restrictions in place anymore but CAs noting the need for a conservative approach in assessing payouts.

[42] Regarding remuneration policies, in 2020 expectations were set to have a larger part of the variable remuneration to i) be deferred for a longer period and ii) a larger proportion to be paid out in instruments. A (partial) assessment of the impact of the EBA recommendations on the actual behavior of institutions may come from the benchmarking exercise covering 2020 and 2021, to be performed in the course of 2022.

[43] Dividend payments and share buy-backs in 2020 amounted to less than EUR 8bn, which represents a pay-out ratio of 9% based on banks' 2019 profits, against an average pay-out ratio of 59% for the previous five years (2015 to 2019).

[44] ECB Banking Supervision for instance asked banks to limit dividend payments to below 15% of cumulated 2019-2020 profits and not higher than 20 bps of CET1 ratio.

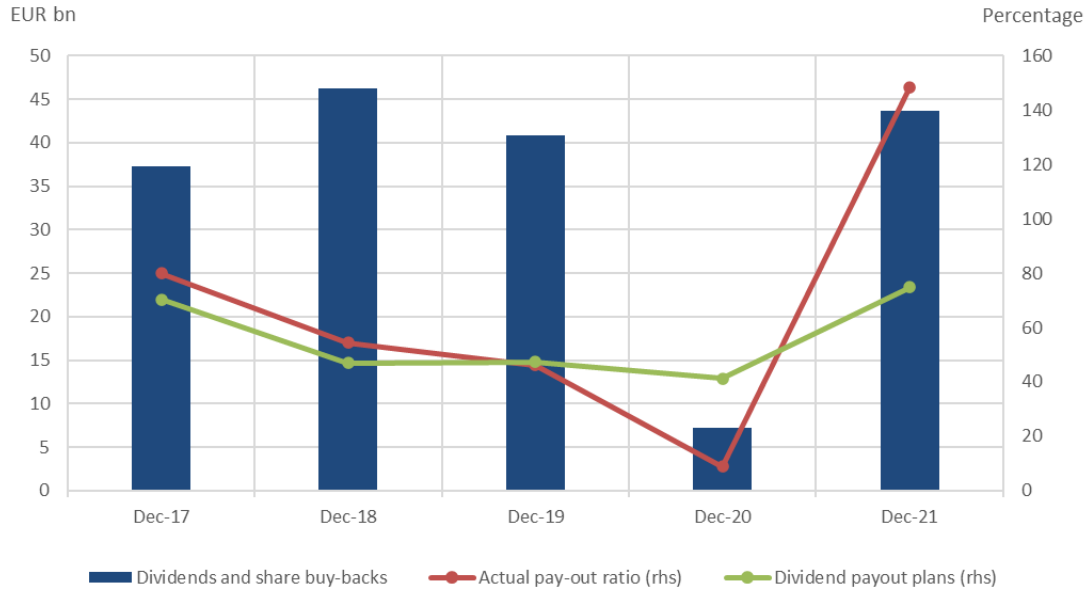
[45] Recommendation of the European Systemic Risk Board of 15 December 2020 amending Recommendation ESRB/2020/07 on restriction of distributions during the COVID-19 pandemic (ESRB/2020/15) (europa.eu)

ECB decides not to extend dividend recommendation beyond September 2021 (europa.eu)

97. Supervisors continue to assess and decide on a case-by-case basis which institutions possess solid capital that allows for dividends payments. In some cases, supervisors are asking banks to limit the amount of capital that could be distributed to shareholders or to link the payouts to capital position.

98. Figure 9 depicts the considerable increase in the payout ratio in 2021 compared to the 2020 payout ratio[46] and the fact that dividend payments in 2021 reached back pre-pandemic levels. For 2022, the dividend plans point towards a 50% payout ratio, which is roughly the long-term average.

Figure 9: Dividends and share buy-backs



Source: EBA Supervisory Statistics.

4.1.4 Recovery planning

99. In terms of recovery planning, for 2020 in line with the EBA statement on supervisory measures the majority of CAs asked institutions to adapt the recovery plans to the new conditions and to focus on core parts of the recovery plan in particular recovery options including overall recovery capacity, indicators and scenarios. Also, most CAs granted operational relief on some parts of the recovery plan that remain relatively stable while also limiting the scenarios to the description of a system-wide Covid-19 scenario.

100. For 2021, recovery plans returned to pre-pandemic normality in terms of operational relief. However, few authorities maintained a more limited number of scenarios focused on the possible economic and financial fall-out of the Covid-19 pandemic.

[46] Although the distributions in 2021 reached similar levels to those in 2018 and 2019, the pay-out ratio was much higher due to the low profits reported in 2020.

101. It is expected that for 2022 CAs will stop granting any operational relief measure while continuing to focus on the core parts of the recovery plan.

4.2 Accounting framework: IFRS9 quick-fix and monitoring overlays

4.2.1 IFRS 9 quick-fix

102. IFRS 9 transitional arrangements were originally introduced in the CRR in 2017 to mitigate the impact on institutions' own funds of the first-time application of the IFRS 9 standards. These provisions were set to gradually expire by December 2022.

103. In light of of the Covid-19 pandemic, those CRR provisions were extended in the CRR Quick Fix[47] with the intention to limit unintended effects in the institutions' regulatory capital resulting from a potential significant increase in the ECL under the Covid-19 crisis. As a result of these amendments, the IFRS 9 transitional arrangements were additionally extended by two years, until December 2024. Institutions were also authorised to reverse the approach initially selected with respect to the IFRS9 transitional arrangements, while competent authorities should ensure that such reversals are not motivated by considerations of regulatory arbitrage.

104. In addition, institutions were allowed to fully add back to their CET1 capital any increase in new ECL provisions that they recognised in 2020 and 2021 for their financial assets that were not credit-impaired. As regards the amounts being previously added back to CET1 capital, no changes were made in terms of schedule nor add-back percentage to be considered in each year. This mechanism guaranteed that ECL already reflected in CET1 as of December 2019 would not be neutralised under the new regime of IFRS 9 transitional arrangements, unless there was a change in the respective approach applied by a certain institution. Finally, the EBA was given a more prominent role, as CAs are to notify the EBA at least on an annual basis on the application of transitional arrangements by institutions under their supervision.

105. Further, to mitigate the potential negative impact on institutions' regulatory capital of the volatility in central government debt markets during the Covid-19 pandemic, a temporary prudential filter to neutralise the impact was deemed warranted. Hence the CRR Quick Fix introduced an optional temporary treatment of unrealised gains and losses measured at fair value through other comprehensive income corresponding to exposures to central governments, to regional government, local authorities and public sector entities, applicable from 1 January 2020 to 31 December 2022.

106. As presented in the EBA IFRS 9 monitoring report published in November 2021, only few institutions decided to take advantage from the changes introduced by the CRR Quick Fix. As regards the types of selected approaches, among the institutions applying these provisions as

[47] Please refer to Article 473a of Regulation (EU) 2020/873 of the European Parliament and of the Council of 24 June 2020 amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards certain adjustments in response to the COVID-19 pandemic (the CRR Quick Fix).

of December 2020, the vast majority decided to apply both the static and dynamic component followed by the application of only static or only dynamic component.

107. In overall terms, the use of the newly extended transitional arrangements introduced by the CRR Quick Fix remained limited among the EU institutions. The simple average impact from the application of the IFRS 9 transitional arrangements was equal to 119 bps for the EU banking sector as of December 2020. This level remained broadly stable in comparison with the impacts observed prior to the introduction of the amendments from the CRR Quick Fix.

4.2.2 Monitoring internal model overlays

108. Overlays seem to continue to be widely used, according to EBA's regular interactions with the industry, auditors and financial reporting data. In some cases, releases of Covid-19 related overlays and the recognition of new overlays seemed rather related to the new risks stemming from changes in the macroeconomic environment and current geopolitical situation.

109. From the EBA perspective, the use of overlays is well understood in case of exceptional circumstances. However, the use of overlays should be well supported by strong governance processes, documentation and principles. While some degree of adjustment to the models is to be expected, the nature and significance of these adjustments over time should be closely monitored. Additionally, supervisors should pay attention to the rationale behind the integration of existing overlays into the models or their release after a certain period of time.

110. The current EBA IFRS 9 monitoring exercise gives prominence to the SICR assessment and ECL measurement, including overlays. Following the experience acquired by banks in the last few years where such high levels of economic uncertainty were faced, it is important to have a close look at how accounting practices have been adjusted and the consequences in the financial position and regulatory capital levels. Results from these monitoring activities, including where needed recommendations to banks and supervisors, will continue to be regularly communicated by the EBA.

4.3 Ensuring a harmonized and prudent approach in the use of Covid-19 impacted data

111. The EBA published in June 2022 Principles on Representativeness of Covid-19 impacted data[48] to support supervisory efforts in assessing the representativeness of data for banks using the Internal Ratings Based (IRB) Approach, with the objective to ensure a harmonised approach in the use of Covid-19 data, especially where the use of moratoria and other public measures may have led to changes in default rates.

112. The first principle clarifies that guidance on the data representativeness assessment laid down in the EBA Guidelines on PD and LGD should be applied also in the case of IRB-relevant data

[48] Principles on representativeness of COVID-19 impacted IRB relevant data.pdf (europa.eu)

impacted by the Covid-19 pandemic and related measures. The second principle clarifies that a significant decrease in the average of a relevant IRB risk parameter estimates compared to end-2019 should be analysed in more depth, with particular attention to any potential representativeness issues on input parameters. The third principle deals with the default and loss rates observed during the pandemic and clarifies that in case of non-representativeness of such rates, a recalibration to lower long-run averages should be postponed until it is sufficiently certain that the trend of decreased realisations is sustainable. Finally, the fourth principle tackles recalibration of downturn LGD in the context of the Covid-19 pandemic, with an EBA recommendation that potential downward recalibrations of downturn LGD are postponed at least until it is sufficiently certain that the effects of the crisis have materialised in the observed loss rates.

5. Conclusion

113. An exceptionally broad set of support measures were swiftly put in place to alleviate the effects of the Covid-19 crisis. This included actions aimed at the EU banking sector to ensure the flow of lending to the real economy amid the extraordinary circumstances triggered by the pandemic and the associated short-term liquidity challenges.

114. Prompt actions taken at EU level, coupled with efficient coordination with member states and the flexibility left at the national level, proved successful in addressing the crisis. This was enhanced by the agility of the EU regulatory architecture with the swift development of Guidelines, and the flexibility embedded in the prudential framework.

115. The progressive weaning of policy support is leading the path to normalisation and the return to pre-pandemic standards, while vigilance continues to be exercised, in particular where public support measures are still currently in force or in the process of being phased out.

116. Overall the EU banking system has proved resilient to the Covid-19 crisis, preserving adequate capital ratios, displaying on average improved asset quality and continuing to hold substantial liquidity. However, the wide-ranging spectrum of support measures helped weather the crisis and does not give room to complacency on the resilience of the framework, which is to be further strengthened with a loyal and swift implementation in the EU of the Basel III reforms.

117. Meanwhile the Russian invasion of Ukraine and the uncertainties associated to the economic outlook bring new risks, albeit of a different nature than during the pandemic. Room for public support manoeuvre seems more limited than at the onset of the pandemic in March 2020, on the back of downward growth prospects and raising financing costs. Further, while the Covid-19 crisis was associated with liquidity challenges, the current juncture seems to raise concerns from a solvency angle, hence a different approach would be required to address any potential materialisation of risks.

Annex: Full timeline of EBA actions

Statement · Guidelines · Technical Standards · Report

EBA statement on actions to mitigate the impact of COVID-19 on the EU banking sector
12 March 2020

- Statement on the application of the prudential framework regarding Default, Forbearance and IFRS9
- Further actions to support banks' focus on key operations: postponed EBA activities
- Statement on dividends distribution, share buybacks and variable remuneration

25 March 2020

- Statement on restrictions on dividends and other distributions
- Statement on actions to mitigate financial crime risks
- Statement on supervisory reporting and Pillar 3 disclosures

31 March 2020

Guidelines on legislative and non-legislative moratoria on loan repayments
02 April 2020

Amending RTS on prudent valuation
22 April 2020

- Statement on additional supervisory measures
- Statement on the application of the prudential framework on targeted aspects in the area of market risk

22 April 2020

Joint RTS on amendments to the bilateral margin requirements under EMIR
04 May 2020

Guidelines on reporting and disclosure of exposures
02 June 2020

EBA extends deadline for application on its Guidelines on payment moratoria
18 June 2020

Statement on resolution planning
09 July 2020

Guidelines on pragmatic SREP 2020
23 July 2020

Report on the implementation of selected COVID-19 policies (I)
07 August 2020

- Guidelines on supervisory reporting and disclosure requirements in compliance with the CRR 'quick fix' in response to the COVID-19 pandemic
- Guidelines amending Guidelines EBA/GL/2018/01 to ensure compliance with the CRR "quick fix" due to COVID-19 pandemic

11 August 2020

Final report on the draft ITS on supervisory reporting (CRR quick fix in the light of COVID-19)
11 August 2020

Statement on banks' distribution policies
15 December 2020

Report on the implementation of selected COVID-19 policies (II)
29 January 2021

Statement on the application of COVID-19 reporting after 2021
17 January 2022

Repeal of the Guidelines on COVID-19 reporting and disclosure from 1 January 2023.
16 December 2022

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