Chapter 21

European Association of Public Banks

EAPB STATEMENT ON THE ROLE OF PUBLIC BANKS IN THE CONTEXT OF THE COVID-19 CRISIS[1]

The European Union (EU) has been quick to react, thanks to its experience with the 2008/09 financial crisis, by effectively loosening the rules on national spending. However, it must be ready to organize a long-term response to the Covid-19 crisis. After easing the lockdown restrictions and starting up the economy in most of the EU countries, economic activity is still low. In addition, many companies still need liquidity to start their business again. Others will need a re-capitalisation to maintain their business. Once the first phase of the crisis is overcome, fiscal financial stimulus will also be required over the recovery phase.

All EU resources of the Next Generation EU and the next Multiannual Financial Framework (MFF) need to be mobilized to ensure a quick recovery while putting the European economy on a sustainable path. Despite the huge costs stemming from the immediate need to recover from the Covid-19 crisis, the EU should be careful not to cut investments in those sectors, which are very important for the future of the EU. It is also crucial to provide local authorities

[1] This is a revised report written by the European Association of Public Banks (EAPB) on the Covid-19 crisis, first published in July 2020, and reproduced with the permission of EAPB. The EAPB has 91 member institutions in the region.

and small- and medium-sized enterprises (SMEs) with the funding they need in a long-term perspective.

The network of European, national and regional promotional banks and municipal funding agencies has been an essential asset in dealing with the economic consequences of the Covid-19 pandemic. Because of the complexity of the situation and the different needs, National Promotional Banks (NPBs) are uniquely equipped to provide the necessary mix of financial products and associate the private sector. About €1 trillion of public support measures have been provided by public promotional banks.

The unprecedented challenges that the European economy is facing must be tackled with all available means and tools at our disposal, ranging from public grants, subsidized loans to guarantees, equity measures and moratoria on loans.

The European financial sector will emerge from the Covid-19 crisis with more non-performing loans and weaker capital and liquidity positions. Consequently, the normal regulatory framework should not be reintroduced without appropriate transition periods in order to allow banks that have taken advantage of the capital relief to support the real economy sufficient time to rebuild their capital.

INTRODUCTION

The Covid-19 pandemic is a shock of unprecedented magnitude and uncertain duration. Many fear that the supply shock in a big part of the economy, coupled with a broader demand shock, could trigger a contractionary spiral. Financial relief to businesses is essential – both to allow them to cope during the period of lockdowns and social distancing, and to ensure that they recover afterwards.

This is why this emergency situation has called for unprecedented credit guarantees provided by governments to make sure banks keep lending. It is, however, clear that, due to the unusual nature of the shock, it will often irreparably damage small businesses and

other parts of the economy, e.g. the retail sector, cultural and creative industry, tourism and so on. Even subsidized loans may be too much of a future burden for small firms to maintain employment if they face the consequences that periods of (nearly) complete shutdown bring about. In these cases, equity or grants are also necessary, either to bridge the crisis or to restructure the company if it fails to limit social hardship through public aid.

IMMEDIATE EU RESPONSE AND NPB COORDINATION

While the main financial power remains at the level of national governments, especially those of the largest Member States, it is important to recognize the speed with which the European Commission has reacted to mitigate the economic consequences, e.g. by quickly cutting down EU-level restrictions by activating the suspense clause of the Stability and Growth pact, by introducing a temporary state aid framework allowing for larger support of companies with Member State coffers, and by introducing temporary changes in regulation to promote incentives for credit expansion via the Capital Requirements Regulation (CRR) quick fix.

To be able to react with such speed, the EU has benefited from its experience with the 2008 response to the financial crisis. The second advantage compared to the 2008 financial crisis has been the well-established cooperation framework of European, national and regional promotional banks and funding agencies. Additionally, the Juncker Plan has been implemented to create growth and is to be followed by InvestEU, with a crucial participation of NPBs. All this has created synergies, joint procedures and (often digital) communication channels that can be used in the current crisis. Within days the EAPB organized multiple exchanges with all important actors and helped build and deploy the necessary instruments.

Building on past experience, the European Investment Bank (EIB) Group has quickly mobilized available European Fund for

Strategic Investments (EFSI) funding, to be deployed in close co-operation with NPBs. This was complemented by the re-direction of unused EU Structural Funds, taking up the advice of NPBs on how to cut administrative burden in record-speed legislative procedures, together with the European Parliament and Member States.

ROLE OF PUBLIC BANKS IN THE COVID-19 CRISIS

Because of the complexity of the situation and different needs, NPBs are uniquely equipped to provide the necessary mix of financial products and assist the private sector. Benefiting from the quick adaptations of the EU, the national and regional promotional banks and funding agency members of the EAPB have taken measures in response to the Covid-19 crisis, fulfilling their role as counter-cyclical state instruments. Their high-level intervention capacities have been fully available to participate actively in Europe's economic recovery.

National governments and promotional banks, together with commercial banks, have worked hard within the joint on-lending system over the last months to ensure the supply of credit to the economy – from SMEs to large companies. All parties involved have also worked to ensure that self-employed persons would be able to benefit from aid. By considerably expanding certain well-established programmes and procedures, banks have rapidly made available support for the financing of enterprises in temporary difficulties.

Investments – and above all working capital – can now be financed by the intermediary banks in a speedy process, while promotional banks were able to lower interest rates significantly. We believe the schemes are fulfilling their counter-cyclical function. In many cases, promotional banks disbursed funding directly to beneficiaries. Many of our members have made use of the possibility of a 100% guarantee coverage for the immediate provision of working capital loans, in order to respond to the request by the intermediary

banking sector to minimize its risk exposure. Almost €1 trillion has been made available to be distributed by NPBs (a total of about 3 trillion Euros of aid measures – all public support measures included – has been notified to the European Commission (EC) as of end July 2020). That is, about a third of total public support measures have been provided by public promotional banks (see Annex 1 for specific individual NPB schemes notified).

All public bank members, be they promotional or commercial, have moreover played an important role by putting in place key measures: maintaining physical access by keeping large number of branches open; enabling online requests for payments and interest deferrals; increasing account limits to maintain customers' solvency; and finally, providing enterprises with in-depth advice on liquidity, financial planning and subsidies.

PHASE OF RECOVERY PRIORITIES – NEED FOR LONG-LASTING REGULATORY ADAPTATIONS AND TARGETED EU ACTION

Once the first phase of the crisis is overcome, financial stimulus will also be required over the recovery phase. After easing the lockdown restrictions and starting up the economy in most of the EU countries, the economic activity is still low. And many companies still need liquidity to start their business again. Others will need a re-capitalization to maintain their business. Therefore, the EU and Member States will need to continue to stimulate employment and economic activity, without aggravating health-related risks.

Priority 1: New MFF/Next Generation EU Recovery instrument: Need for strong funding mechanisms for companies and public sector investment for the sustainable and digital agenda

EAPB members welcome the new EC proposal for the Multiannual Financial Framework (MFF) and the agreement of the European Council from 21 July 2020. The agreement by Heads of State on the

creation of the Recovery Instrument, with a mix of loans and grants totalling €750 billion, is a historic move for the EU. However, despite the huge costs stemming from the immediate need to recover from the Covid-19 crisis, the EU should be careful not to cut investments in those sectors that are very important for the future of the EU. We advocate a rapid conclusion of the negotiations on the MFF, the rules concerning Structural Funds/Cohesion policy and on an ambitious InvestEU Programme. It is essential to provide both legal certainty and adequate funding for the 2021-2027 programming period – not only for promotional banks but also for the final beneficiary. Due to the lockdown restrictions, many projects are delayed or more support is needed.

In order to really be capable of supporting the recovery, the EU budget should be *made more investment oriented*. Now is the right time to do even more in the areas of, for example, infrastructure, energy, innovation and mobility. Promotional banks should be enabled to continue support programmes set up with the help of Structural Funds and EU guarantee facilities – under COSME, InnovFin and EFSI – also after 2020 in order to ensure continuity and reliability in support. The InvestEU financial products should offer adequate flexibility (for example, in terms of risk assumption or scope) and allow for combination with other funds. This will enable intermediaries to offer tailor-made solutions in line with different needs of final beneficiaries following the crisis.

The focus has been rightly put on SME financing (and in justified cases larger companies) as those were the first economic victims of the Covid-19 crisis. It was important for the EU to reallocate all available funding to short-term liquidity aid to European firms (e.g. working capital, credit lines). For the recovery fund now to be a success, *the access to liquidity for SMEs must be maintained and operationalized in an unbureaucratic and timely manner*, using proven cooperation partners and distribution networks. In this perspective, we have very much appreciated the intention to include national promotional banks in the envisaged pan-European guarantee fund operations. Any new

funding *and EIB Group operations must be developed in close cooperation with the national and regional promotional banks and funding agencies* in the respective Member States in order to ensure the highest possible impact and additionality. Moreover, the new products should be complementary to existing ones and avoid the crowding-out of financial support programmes at national/regional level.

Also, while businesses, and in particular SMEs, have been a natural target for support measures during the first phase of the crisis, *the public sector* must be taken on board over the months to come in strategic recovery planning. In the medium to long term, keeping the public sector up to speed will be a crucial key to pushing the recovery forward. With the public sector going into a savings or even austerity mode, many of the positive dynamics may be lost. Therefore, finding the right balance between the private and public sectors in the allocation of resources will be a very delicate task. If we do not get this right, the recovery will suffer. We now hear from a number of municipalities and regions across Europe that they would be happy to execute and even reinforce existing investment plans. Investment needs are immense and diverse: immigration, demographic change, urbanization and the green transformation are just a few examples. We expect lending to municipalities and regions to continue to increase sharply over a number of years. However, if they were to get into financial difficulties – for example, if the national government does not compensate for Covid-19 related income losses (in particular due to the loss of business taxes) and added expenditures – the investment plans would quickly be delayed or even rendered unviable. This would in turn be very negative for the economy as a whole. Therefore, *quick compensatory injections into the budgets of municipalities and regions* are crucial at this point in time to ensure their continued investment capacity. Public banks and municipal funding agencies will play their role in this area as well.

The funding priorities mentioned above will also require further *adaptations to State aid regulations*. We welcome the EC initiatives to support equity measures in the temporary framework.

Many of these measures would be beneficial as part of a permanent framework, such as the simplified rules for subordinated loans. State aid rules should also encourage the set-up and promotion of tele-medicine as part of services of general economic interest. As we fear that the aftermath of the pandemic will be perceptible for some time, it should be also examined whether the measures of the Temporary Framework could be extended beyond December 31, 2020.

Priority 2: Proportionality for public development credit institutions and promotional loans in regulation

We highlight the importance of considering possible exit scenarios for all the relief measures. Banks will emerge from the Covid-19 crisis with more non-performing loans and weaker capital and liquidity positions. Consequently, the normal regulatory framework should not be reintroduced without appropriate transition periods in order to allow banks that have taken advantage of the capital relief to support the real economy sufficient time to rebuild their capital. This is particularly salient for public banks, since they cannot simply turn to the capital markets to raise capital but can only raise capital through retained earnings.

Furthermore, it will be important to strengthen proportionality for those promotional banks and municipal funding agencies, which are under European Central Bank (ECB) supervision and/or those directly and indirectly subject to EU regulation moving forward. Last, but not least, future regulatory projects should also be reviewed as a matter of principle and accompanied by thorough, up-to-date impact analyses that adequately balance the benefits and costs of these projects. We would like to share our thoughts and further details on necessary quick fixes and future Capital Requirements Regulation (CRR) and other regulatory changes, i.e. beyond the current ‘quick fix’ that could mitigate the impact of the current Covid-19 pandemic. For this purpose, please see Annex 2 for a list of measures that would be crucial in our view.

Priority 3: Sustainable finance

A third key priority of the financial services agenda for our members is sustainable finance. As 80% of EAPB members provide funding to green projects, and many are leading issuers of green and sustainable bonds, the further progress of EU activities in this area, with the action plan on sustainable finance at the core, will be of great importance for us. Moreover, the challenge Covid-19 represents to our healthcare and social systems must be approached as the right opportunity to boost the social component of sustainable finance and concentrate on developing the concept of social bonds. Once again, some EAPB members already have solid experience as social bond issuers and stand ready to share their experience.

Priority 4: An actively engaged European Central Bank

The role of the European Central Bank (ECB), already determinant during the 2008 crisis, has been of fundamental importance in the Covid-19 crisis. What types of assets central banks can/will buy within quantitative easing programmes can rather substantially alter the dynamics of key parts of the credit market – not least when it comes to the issuing of actors of, or linked to, the public sector. In this context, we look forward to continuing our excellent dialogue with the *ECB*, both on supervisory but also monetary policy issues.

ANNEX 1: NPB COVID-19 MEASURES NOTIFIED AND PUBLISHED (STATUS JULY 22, 2020)

National Promotional Bank (and policies)	Euros (bn)	Source
Altum SA.56722 Latvia, Covid-19: Loan guarantee scheme and subsidized loan scheme	0.25	EC
BGK: SA.56876 Poland, Polish anti-crisis measures – Covid-19 – guarantee scheme, Polish Development fund (with BGK): repayable advances for SMEs (SA.56996), large enterprise liquidity loans (SA.57306) + damage compensation and liquidity (SA.57054) + equity measures (SA.57055) + interest rate subsidies (farmers) (SA.57568)	44.14	EC
BPI France (Groupe CDC), SA.56709 – Covid-19: Plan de sécurisation du financement des entreprises, SA.56868: Garanties des préfinancements des entreprises exportatrices, + SA.57219 (cautions export)	311.1	EC
Bulgarian Development Bank Guarantee scheme (SA.56933)	0.255	EC
CDP, Italy	10	IMF
CMZRB, Czech Republic: loan guarantees (SA.57195)	5.5	EC
Finnvera, Finland, Scheme of state guarantees and subsidized interest rates	2	EC
HBOR, Croatia: Loan scheme (SA.56957) + support to the maritime, transport, transport infrastructure, tourism, and related sector (SA.5771)	1.08	EC
Hungarian Development Bank (SA.57121 + amendment) + SA.57064	0.9	EC
ICO: SA.56803 Spain, Covid-19 - Guarantee scheme to companies and self-employed	20	EC

INVEGA: Lithuania/Interest subsidy scheme + guarantee scheme + loans in road freight transport (SA.57066) + rent compensation (SA.57135) + guarantees and loans for tour operators, accommodation and catering service provider (SA.57665)	0.736	EC
KfW and German Regional Promotional Banks: SA.56863, Federal framework for subsidized loans 2020, SA.56790 €45 bn, Federal Framework 'Small amounts of aid 2020' - Covid-19, SA.56787, Covid-19: Bundesregelung Bürgschaften 2020, SA.56714 - Covid-19 measures, new measures approved on 11 April: 100% guarantees + R&D (SA.57100,€5 bn)	550	IMF, press
Kredex: SA.56804 Estonia, Loan guarantee scheme + SA.57028	2.75	EC
Malta Development Bank: SA.56843, Covid-19 Loan guarantee scheme + interest rate subsidy scheme (SA.57163) + loan to Mediterranean Investments Holding (SA.57574)	0.77	EC
PMV, Belgium, loan guarantee + SA.57246 (subordinated loans) + Credendo Bridge Guarantee (export, SA.57187), SOWALFIN and Co. (Walloon region guarantees, SA.57083)	4.28	EC
SID Bank (and others), Slovenia, SA.56999 +SA.57143 + SA.57724	4.272	EC
Slovakia: EXIMBANKA (SA.57483, SA.57484, SA.57485)	1.8	EC
TOTAL	**€960,855**	

ANNEX 2: EAPB VIEWS ON NECESSARY REGULATORY ADAPTATIONS

With regard to regulatory aspects, EAPB generally welcomes the adaption of a number of regulatory and prudential rules to ensure a greater impact of private sector bank lending and public support instruments. In particular, the Capital Requirements Regulation (CRR) quick fix will lead to capital relief and help banks to provide more urgently needed loans. However, we see leeway for these rules to be supplemented by further regulatory changes that effectively curb the known crisis-intensifying effects of prudential regulation and provide administrative relief.

No ‘punitive’ contribution to the resolution fund when participating in promotional loan programmes

When calculating the contribution to the resolution fund, participation in promotional loan programmes should not be ‘penalized’ with a higher bank levy.

In order to fix this, EAPB would propose to amend Delegated Regulation (EU) 2015/63 on the calculation of the EU bank levy to the effect that:

- Passing-though promotional loans to an end customer or of trustee loans has a contribution-neutral effect
- Promotional loans from promotional banks, which have been excluded from the leverage ratio exposure measure in accordance with Art. 429a CRR 2, can also be deducted from the leverage ratio when the latter is used as a risk indicator for calculating the contribution to the Single Resolution Fund

More generally, EAPB would propose a BRRD Quick-Fix in order to bring forward relief measures already decided in BRRD 2 (removal of the Combined Buffer Requirement (CBR) from MREL) similar as it has been done in the CRR quick fix.

Avoid constraints through leverage ratio disclosures
The current leverage ratio disclosures requirements apply as a constraint to banks due to market scrutiny. We recommend bringing forward the date of application of the proportional calculation of the leverage ratio agreed under the CRR 2 (such as promotional loans by promotional banks in accordance with Art. 429a CRR 2) so that this applies not only starting in June 2021 but also in the current disclosure requirements. Such a measure would increase the effectiveness of the policy responses to the Covid-19 crisis.

Avoid pro-cyclical effects in banking regulation
Risk-sensitive capital requirements have pro-cyclical effects. This correlation has been known for a long time, but has so far only been tackled in banking regulation with regard to an advantageous economic development. For example, the countercyclical capital buffer ensures that banks build up additional capital buffers in times of good economic development associated with high credit growth in order to be prepared for a downturn. However, risk-sensitive capital requirements also have the effect of compounding the cycle in bad times especially when capital buffers are not sufficiently above minimum capital requirements and raising new capital is difficult. This risk is particularly acute in the event of unexpected macroeconomic shocks that lead to a significant decline in overall economic production or demand within a short period or that affect both supply and demand, as during the Covid-19 crisis. It is foreseeable that this crisis will – in spite of extensive government countermeasures and supervisory flexibility – lead to rating downgrades and loan defaults even for companies that would have been considered economically sound under normal circumstances. This entails the risk of a corresponding increase in capital requirements and thus a reduction in the banks' lending possibilities, which in turn could further intensify the economic downturn and make it more difficult to grant urgently needed new loans during the economic recovery phase. A staged series of measures is proposed below, which, depending on the course of the

crisis, could be taken to address this problem.

As the European Banking Authority (EBA) has rightly noted, European banks are entering this crisis with sound capital ratios. It is of the utmost importance that this capitalisation is not reduced unnecessarily during the crisis. This is already in the banks' own interest. It is therefore important for us to stress that we do not argue in favour of reducing banks' capital in absolute terms during the crisis, but to introduce counter-cyclical measures that would offset a sharp undesirable increase in capital requirements due to their risk sensitivity, which would increase the scale of the crisis and hinder the subsequent economic recovery.

The EAPB believes that we need to create new powers for the Commission or competent authorities to be prepared for a possible intensification of the crisis. Whether these powers will ultimately be used is open at this stage. However, we think that they should be available in case of urgency.

Empowerments for the Commission to adopt counter-cyclical measures (Art. 459 CRR)

Member States may impose additional Common Equity Tier 1 capital requirements on institutions in economic upturns with strong credit growth for loans extended in the country concerned in the form of a countercyclical capital buffer of up to 2.5% of RWA. This is intended to provide the banks with provisions in the event of an economic downturn. In the course of the relief granted in the Covid-19 crisis, numerous national supervisory authorities have reduced the respective countercyclical capital buffer. This is to be welcomed.

However, it should also be possible to temporarily reduce prudential requirements in times of significant macroeconomic shocks. The EAPB would propose to entrust the Commission with a role in making temporary adjustments to the framework in exceptional situations that mirrors the mandate for a delegated act, laid down in Article 459 of the CRR.

Article 459 empowers the Commission to impose stricter re-

quirements than those in the CRR in clearly specified areas and for a period of one year. The exercise of this empowerment is backed by stricter accountability rules requiring the Commission to submit regular reports to the European Parliament and Council.

The EAPB would propose to extend this empowerment in a well-framed manner in order to allow the Commission to adopt exceptional well-targeted relief measures. This would help to address emergencies such as a potential credit crunch due to a sharp increase in capital requirements or a significant macroeconomic shock triggered by a second infection wave. These exceptional relief measures should at the least include the prudential requirements explicitly mentioned in Article 459.

Furthermore, the impact of credit defaults and deteriorated ratings on capital requirements could be mitigated in exceptional emergency situations and under the discretion of competent authorities or the Commission.

In the internal ratings-based approach (IRBA), rating downgrades and defaults lead to an increase in capital requirements, primarily via three channels:

1. Rating downgrades and the associated increase in the probability of default (PD) via the risk weight functions for exposures to sovereigns, banks and corporates (Art. 153 CRR), and retail customers (Art. 155 CCR) affect the amount of capital to be held. However, this effect decreases as the PD increases, ultimately becoming negative.
2. This is because institutions using the IRBA must form a separate, increasing provision for expected losses. Within the scope of the value adjustment comparison (Art. 159 CRR), banks must compare the expected losses with the value adjustments made and deduct any shortfalls from equity. In this way, an increase in PD or a default (leading to the highest possible PD of 100%) leads to a consumption of regulatory capital, either through the creation of additional value adjustments or the deduction of capital.

3. Finally, yet importantly, defaults also have an impact on the capital position of institutions via the provisions on the minimum coverage of non-performing exposures (so-called 'NPL backstop' (Art. 47a CRR). Accordingly, defaulted loans must be regarded as 'non-performing' in accordance with Art. 47a para. 3 part a CRR. For such loans, the banks may, over time, then have to set up additional risk provisions, depending on the collateralisation.

Therefore, the EAPB would propose the following measures:

1. Banks could be allowed to adjust their PD estimates to partially or fully offset the impact of a non-cyclical economic shock that negatively affects the risk factors of the PD estimate for a short period of time (no longer than two years). Such an adjustment of PD estimates should be permitted where the risk quantification would otherwise be inaccurate and disproportionately conservative: for example, because the crisis is likely to be followed by a strong economic recovery.
2. In this sense, it could also be considered to modify the requirements in Art. 185 part E of the CRR for a certain period. According to this provision, banks must increase their PD estimates if the actual default rates differ so significantly from the estimated PD that the validity of the estimates is called into question. Institutions may be allowed to choose not to adjust PD estimates in the short term, but to base them on long-term experience and expectations.
3. Finally, yet importantly, a countercyclical factor could also be included in the risk weighting function, which slows down the increase in capital requirements as PD increases in certain economic situations.

Consideration could be given to repealing the NPL backstop requirements in a severe non-cyclical crisis, or at least to extending the period within which provisions must be built up.

If, in view of the course of the crisis, the above-mentioned measures do not appear to be sufficient, the Commission should have

the discretion to suspend temporarily (e.g. three months):

- The requirement of a timely review of ratings upon the disclosure of material information about the borrower (Art. 173 para. b of CRR).
- And the default criteria:
  - "putting the credit obligation on non-accrued status" (Art. 178 para. 3 part a of CRR).
  - "recognition of a significant specific credit adjustment" (Art. 178 para. 3 part b of CRR).
  - and "distressed restructuring" (Art. 178 para. 3 para. 3 part b of CRR).

Alternatively, similar powers could be entrusted to competent authorities under the condition that they are applied in a uniform manner within the EU.

Postpone first-time application of the CRR II

In order to relieve the burden on institutions, the remaining first dates of application of the CRR II should also be postponed to a point in time when the economic recovery is already clearly noticeable among companies, private households and banks. In our opinion, the postponement should not only cover those new regulatory requirements that come into force on 28 June 2021, but should also apply to the new reporting requirements for market risk regulations (FRTB), which are to be applied for the first time from the reporting deadline of 31 December 2020.

The implementation of the CRR II will not only lead to considerable administrative burdens in the institutions, but also to considerable future capital burdens. This would have to be taken into account in the capital planning already at this point in time and could thus prevent the banks from providing loans during the crisis.

No negative impact of legacy instruments on the recognition of existing own funds instruments and eligible liabilities

In view of the discussions initiated by EBA on "legacy capital in-

struments", there is an urgent need for legislative clarification in the CRR (Articles 28, 52, 63 and 72b CRR). Legacy instruments held by the institutions should remain harmless to the recognition of existing own funds instruments and eligible liabilities after the end of the transitional provisions of Articles 484 ff. CRR. Legacy instruments contribute to loss coverage in times of crisis. Institutions are often unable to call or redeem them and it would further reduce their capital base. If existing own funds instruments are no longer recognized because the institution continues to hold legacy instruments, the banks' scope for lending would be further reduced.

Recovery package

Targeted adjustments of MiFID/MiFIR and the Prospectus Regulation can help to stimulate the capital market in the EU and generate additional funding for crisis management. In this respect, we support the planned proposals of the European Commission and the High-Level Forum on capital markets union.

Provisioning schedule for government-guaranteed NPEs

EAPB welcomes the new treatment for government-guaranteed NPEs that removes the build-up phase for the first seven years under the CRR quick fix. However, the new prudential treatment has not removed our key concern, being that provisioning has to take place even if the guarantor is acting to its commitment, and payments are received according to schedule.

First, the guarantee cannot be called upon as long as the borrower is paying according to schedule. Nevertheless, such a loan might classify as an NPE, for instance, due to a pulling effect or when it is assumed unlikely that the borrower will repay. Hence, there can be a mismatch between when the guarantor has to act on its commitment and when a loan classifies as an NPE. As such, the provisioning schedule is applicable for exposures that are expected to be covered by the guarantor.

Second, a guarantor can either indemnify a lender by direct

payment of the covered amount (lump sum) or indemnify the lender according to the original repayment schedule of the loan. The latter being a common occurrence among EAPB members. While in such an event, payments are received according to schedule, technically according to art. 47a of the CRR the exposure should be classified as NPE as the classification relates to the borrower and not to the guarantor.

Given the long-term nature of the loans, the repayment schedule will exceed the provisioning schedule and hence provisioning will be required though payments according to the schedule are received and are expected to be received from the guarantor who is acting to its commitments.

As such, the need for a provision exists even if the cover is an unfunded credit protection and the issuer of the cover continues to perform its commitments.

EAPB would recommend to exempt the covered part of a non-performing exposure from prudential provisioning as long as the borrower is paying on time or the cover is valid unfunded credit protection granted by the guarantor who is performing as scheduled.

Restrictions on dividends for public stakeholders

EAPB would like to draw your attention to the special situation of certain promotional banks/funding agencies when it comes to the restriction of distributions during the Covid-19 pandemic and especially the recent ESRB advice to extend the dividend suspension period until the end of 2020.

We feel that the rationale for the recommendation to not pay out dividends over 2019 does not hold for those promotional banks/funding agencies that pay dividends to their public stakeholders. Promotional banks/funding agencies are generally well-capitalized banks and – where paid out – dividends are generally paid out of profits (and not reserves). Hence, in these cases the distribution of dividend does not deplete available capital, nor does the dividend payment stem from a relaxation in prudential requirements.

Secondly, the suspension of dividends is at odds with the aim to mitigate the economic impact of the pandemic on local authorities. These dividends are usually at the benefit of local public authorities, being the entities that are combatting the health and economic crisis we are currently facing. It is part of the public mission of promotional banks/funding agencies to support their public shareholders, especially in difficult times like these and therefore feel that given their public ownership the rationale for the recommendation does not hold for promotional banks/funding agencies.