COVID-19 and its impact on the financial services sector

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In brief….

The coronavirus outbreak has already had a significant impact on the UK and the global economy, leading to market uncertainty, falls in asset prices, disruption in businesses' cashflows and increased demand for short-term credit. In response to this, UK and EU authorities are taking action to support the economy and facilitate the flow of capital. This article explains how the coronavirus outbreak and the associated measures affect the financial services sector in the EU and UK.

EU

Banking Sector

On 12 March, the European Central Bank announced a series of capital and operational relief measures concerning directly supervised banks. In particular:

- Banks will be able to operate temporarily below the level of capital required under the Pillar 2 Guidance, the capital conservation buffer and the liquidity coverage ratio.
- In addition, banks may partially use capital instruments not qualifying as Common Equity Tier 1 capital, such as Additional Tier 1 or Tier 2 instruments.

These measures aim to provide banks with temporary capital and operational relief so they can continue financing the economy during this downturn. The European Central Bank notes, however, that banks should not take advantage of these measures to increase dividend distributions or renumerations.

In addition to the above, on 20 March the ECB announced further measures for directly supervised banks. In particular, the ECB introduced supervisory flexibility with regards to the treatment of non-performing loans (NPLs), to allow banks to benefit from guarantees and moratoriums that are being put in place by a number of public authorities. The ECB also encourages banks to avoid excessive procyclicality of regulatory capital in the application of the IFRS 9 international accounting standard.

The ECB estimates that the combined effect of the above measures will release EUR120 billion in CET1 capital, which will be available to banks to absorb losses or to potentially finance up to EUR1.8 trillion of loans.

Moreover, on 18 March 2020, the ECB announced a package of non-standard monetary policy measures to support the economy in the eurozone during the time of the pandemic. These include the launch a new EUR750 billion temporary asset purchase programme of private and public sector securities (the Pandemic Emergency Purchase Programme or PEPP). Purchases under the PEPP will take place until the end of 2020 and will include all the asset categories which are eligible under the existing asset purchase programme (APP). The European Central Bank also decided to expand the range of eligible assets under the corporate sector purchase programme (CSPP) to include non-financial commercial paper.

The European Banking Authority has also published its own statements. The key messages are the following:

- Banks should focus on their core operations and ensure continuity. To this end, the European Banking Authority will postpone the EU-wide stress test exercise to 2021 and will extend the closing date of ongoing public consultations by two months. National Competent Authorities are also expected to be flexible in the way they carry out their supervisory duties, where it is prudent to do so.
- National Competent Authorities should make full use of flexibility afforded under the current regulatory framework, for example regarding the countercyclical buffer and the liquidity coverage ratio.
- According to the EBA, generalised payment delays resulting from legislative initiatives and addressed to all borrowers should not automatically lead to the borrower being classified as in default, or unlikely to pay.
- In cases where institutions apply the IFRS 9 international accounting standard, they are expected to use a certain degree of judgement and differentiate between borrowers whose credit position would not be significantly affected by the current situation in the long run, and those who are unlikely to be able to restore their creditworthiness.
- The EBA expects lenders to act in the interest of consumers, ensuring, among other things, that any new terms do not automatically have an adverse impact on the customer's credit rating.
- Considering the importance of orderly payments services during this period, the EBA recommended that the limit of contactless payments should increase up to EUR50.

Capital Markets

On 11 March, the European Securities and Markets Authority made the following recommendations:

- All market participants should be ready to implement their contingency plans to ensure operational continuity.
- In accordance with their transparency obligations under the Market Abuse Regulation, issuers must disclose as soon as possible any significant information concerning COVID-19 that may affect their fundamentals, prospects or financial situation.
- Issuers must disclose in their 2019 year-end financial reports or – if those have already been finalised – in their interim financial reporting disclosures actual and potential impacts of COVID-19 on their business, financial situation and economic performance. However, in a subsequent statement ESMA acknowledged that issuers might experience difficulties with submitting accurate financial statements in time and therefore recommended that National Competent Authorities should allow for certain delays in this regard.
- Asset managers must continue to apply the risk management requirements applicable to them and react accordingly.

ESMA also decided to extend the response date for all ongoing consultations with a closing date on, or after, 16 March by four weeks.

UK

UK regulators have responded quickly to the coronavirus outbreak. On 11 March, it was announced that the Financial Policy Committee (FPC) of the Bank of England had decided to reduce the UK countercyclical capital buffer rate to 0% (from 1%) of banks' exposures to UK borrowers. This measure became effective immediately and the Committee estimates that the reduced 0% rate will remain in place for at least 12 months. It is expected that the release of the countercyclical capital buffer will support the lending capacity of banks up to GBP190 billion.

In light of the FPC's announcement, the Prudential Regulation Authority published on the same day its own supervisory guidance, highlighting that firms should not increase dividends or other distributions following these capital easing measures. In addition, firms are expected to identify a senior manager who will be responsible for overseeing any proposals relating to dividend distributions or share buybacks, which are associated with the reduction of the UK countercyclical buffer rate.

The Prudential Regulation Authority also expects that the individual performing the chair of the remuneration committee senior management function (SMF12) or, if different, the senior manager holding the prescribed responsibility for "overseeing the development of, and implementation of the firm's remuneration policies and practices" should pay due regard to decisions relating to bonus pools.

The FPC's decision forms part of a series of measures taken by the Bank of England to support the UK economy. These include the decision of the Bank's Monetary Policy Committee to reduce the Bank Rate to introduce a new term-funding scheme with additional incentives for small and medium-sized enterprises (TFSME); and to maintain the stock of sterling nonfinancial investment-grade corporate bond purchases at GBP10 billion and the stock of UK government bond purchases at GBP435 billion.

Last, the Financial Conduct Authority announced on 17 March its plans to postpone certain regulatory activity, to extend the date for responses to its open consultation papers and calls for input until 1 October 2020, and to reschedule most other planned work. In particular, the FCA will relax its programme of routine business interactions, and it will be focusing on business-critical requests by firms. The FCA has published more information on its website on its expectations of firms during the coronavirus crisis, including how they should treat their customers.

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