Introduction of banking sector regulatory measures announced by the ECB and the Banque de France to contain the effects of the Covid-19 crisis

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In order to contain the effects of the crisis linked to the Covid-19 epidemic, the European Central Bank (ECB) and the Banque de France have announced the implementation of banking sector regulation measures to ensure the liquidity of the interbank market and to guarantee the continuity of financing to companies.

Last update : 20 April 2020

Furthermore, a number of European institutions have announced the introduction of measures to support the national economies of Member States in the context of the Covid-19 health crisis.

The Governor of the Banque de France made it known that the early results of these measures would be communicated, sector by sector, on 8 April 2020 and would result from discussions between the Banque de France and debtor companies.

1. SUSPENSION OF COMPANY RATINGS

In coordination with the ECB, the Governor of the Banque de France has announced the freezing of companies' ratings as of 15 March 2020.

2. MODIFICATION OF PRUDENTIAL REGULATIONS

European and French regulatory authorities intend to ease prudential regulations in order to increase the banks' margin for manoeuvre. For this reason, the period at the end of which a loan that has not been repaid by a company is considered as a bad debt in the banks' balance sheet should be extended.

Currently, banks are required to provision late payment of debts of companies after 90 days. The share of these non-performing loans is also taken into account in the calculation of the credit institutions' solvency ratio, which is closely monitored by the markets.

By extending this period, the banks' bad debt stock will increase more slowly, which will give the banks more flexibility in granting terms of payment to debtor companies.

Furthermore, in a press release on 20 March 2020, the ECB announced that the deadlines for corrective measures imposed by the targeted review of internal models (TRIM) would be postponed by 6 months. The deadlines for the Supervisory Review and Evaluation Process (SREP) mechanism are also being postponed, as are the publication of decisions and other follow-up letters relating to these questions but not yet communicated to the banks.

3. QUANTITATIVE EASING POLICY

The Banque de France and the European Central Bank (ECB) will implement a policy of "quantitative easing" through the repurchase of sovereign and private debt securities from banks and other institutional market players.

This debt buy-back programme was initially financed by a funding envelope of EUR 120 billion. On 18 March 2020, the ECB announced that it would increase this amount to EUR 750 billion.

The repurchase of these debt securities, which will be implemented by the end of 2020, will inject liquidity into the interbank market and consolidate the balance sheet of credit institutions in order to favour the granting of corporate financings.

On 24 March 2020, the ECB decided to extend its programme to debt instruments with a maturity of at least 70 days, compared with one year ordinarily. It also decided to rule out applying the buyback ceiling set at 33% of the debt of each Member state.

In an interview on 26 March 2020, the Governor of the Banque de France announced that the institution would make use of commercial paper (short-term notes), as of this week, as part of its quantitative easing policy.

4. EIB GROUP FINANCIAL PACKAGE

The European Investment Bank (EIB) group announced on 16 March 2020 that it would implement a financial package containing the following measures:

- Specific guarantee programmes for banks, intended to make available up to EUR 20 billion in financing; these new programmes will rely on programmes that already exist in order to be deployed immediately;
- Specific liquidity lines of up to EUR 10 billion for banks, intended to sustain the working capital needs of SMEs and mid-cap companies; and
- Specific programmes for the acquisition of asset-backed securities, allowing for a total amount of EUR 10 billion to be made available.

The European Council expressed its support for the implementation of these programmes in a joint declaration by its members, on 26 March 2020.

The EIB group also announced, in a press release on 3 April 2020, that a EUR 25 billion pan-European guarantee fund would be put in place. The total volume of guaranteed loans which can be drawn on is estimated at EUR 200 billion. The EIB announced that the majority of these funds would be injected into the real economy by financial intermediaries (such as investment funds).

The guarantee fund will be funded directly by Member States, pro rata to their shareholding in the EIB. It is intended for private sector players that are in difficulty but viable in the long-term, and which would be able to obtain commercial funding from other lenders or financial intermediaries.

The Eurogroup adopted this proposal on 9 April 2020. The economic and finance ministers also urged the EIB to render this financial package operational as soon as possible. The EIB Board of Directors approved the Eurogroup's recommendation on 16 April 2020.

5. REFINANCING OF BANKING LOANS BY THE BANQUE DE FRANCE

In a press release dated 13 March 2020, the Banque de France announced that it would refinance debts for the benefit of VSEs and SMEs.

6. LONG-TERM LOANS GRANTED TO THE BANKS BY THE ECB

The ECB will set up long-term loans, known as "TLTRO", for the benefit of credit institutions at a negative interest rate of - 0.75%. Such loans are conditional, i.e. only to ensure the continuity of credit to businesses. The total amount of these loans is not yet known.

The objective of these TLTROs is to guarantee bank liquidity and to encourage banks to increase their lending activity for the benefit of businesses and consumers. Indeed, the amount of money that can be borrowed by banks from the ECB and the level of the interest rate applicable to such borrowings depend on the amount of outstanding loans granted by banks to businesses.

Therefore, banks that lend more to businesses will be able to borrow more from the ECB and at a lower interest rate (they will even be paid, due to the negative interest rates applied).

On 8 April 2020, Christine Lagarde announced that the ECB was making EUR 3,000 billion available. Various instruments, and notably TLTROs, may be used to put these funds to use.

7. MOBILISING THE COUNTERCYCLICAL CAPITAL BUFFER (CCYB)

The countercyclical buffer is a reserve which was built up by banks during a period of favorable economic conditions and which can be released and used to cope with a downturn in the economy due to a crisis. This reserve represents 0.25% of banks' share capital since 1 July 2019 and should increase to 0.5% on 2 April. This share represents around EUR 8 billion, which should in principle be capitalized.

The French High Council for Financial Stability, under the lead of the Ministry of Economy and Finance, decided to release the entire amount, which can now be used, among other things, to grant loans to businesses.

8. TREATMENT OF PAYMENT EXTENSIONS GRANTED TO BUSINESSES

In two press releases on 25 March 2020, the European Banking Authority and the European Securities and Markets Authority stated their support for the new prudential framework.

Furthermore, with respect to the consequences that payment holidays for borrowing companies will have on the banks' balance-sheets:

- Generalized late payments, resulting from the initiatives of Member States, will not automatically lead to the credits concerned being classified as in default, waived or unpaid.
- The accounting valuation of late payments will be carried out on a case-by-case basis, following a risk-based approached; the credit risk analysis has to be carried out independently from the associated guarantees, especially state guarantees

However, the cash flow resulting from enforcing guarantees should be taken into account when calculating expected losses;

- All lenders have to act in the interest of consumers; in particular, they have to make sure that clients fully understand the implications of any measure taken, without hidden costs or automatic negative effects on the client's credit score.

9. EXTENSION IN INSURANCE COMPANY REPORTING OBLIGATIONS

Under the Solvency II Directive, European insurance companies are subject to annual and quarterly reporting obligations to confirm their financial condition.

In a recommendation on 20 March 2020, the European Insurance and Occupational Pensions Authority (EIOPA) granted an extension for reports to be submitted by insurance companies:

- Eight weeks for 2019 annual reporting and the Solvency and Financial Condition Report; and
- One week for quarterly reporting.

The EIOPA has reminded insurance and reinsurance companies that the epidemic should be considered a "major development" within the meaning of Article 54, Paragraph 1 of the Solvency II Directive. These companies are also required to publish all appropriate information on the effects of Covid-19 in their reports intended for the public.

10. TRIGGERING THE EUROPEAN STABILITY MECHANISM (ESM) AND DISCUSSIONS ON THE ISSUANCE OF "CORONABONDS"

The ESM currently has EUR 410 billion available – the equivalent of 3.4% of European GDP - and ready for use. The provision of these funds would be implemented via the Enhanced Conditions Credit Line (ECCL) for the benefit of states experiencing budgetary difficulties.

On 9 April 2020, the Eurogroup adopted a measure to mobilise the ESM. The mechanism will take the form of loans granted by the EU to Member States, subject to the following conditions:

- Loans will be limited to 2% of the GDP of the recipient Member States;
- The funds will be earmarked for "domestic financing of direct and indirect healthcare, cure and prevention related costs due to the COVID-19 crisis".

The Eurogroup committed to implementing the ESM within two weeks, subject to the national procedures and constitutional requirements specific to each Member State. The credit line represents an overall envelope of EUR 240 billion and will remain available until the end of the Covid-19 crisis.

Concerning the potential issuance of "Coronabonds", however, the Eurogroup did not reach a consensus. The Northern European states (particularly Germany and the Netherlands) are particularly reluctant to issue joint debt between all Member States.

However, the idea of sharing bond debt between Member States has not been completely ruled out. On 9 April 2020, the Eurogroup agreed on the principle of creating a Recovery Fund which would be "temporary, targeted, and commensurate with the extraordinary costs of the current crisis" and help to spread these costs over time. This fund would rely on "innovative financial instruments" which remain to be defined. According to Bruno Le Maire, only a mechanism implying debt pooling would allow for these criteria to be met.

11. INVESTMENTS VOTED BY THE EUROPEAN PARLIAMENT TO SUPPORT THE NATIONAL ECONOMIES OF MEMBER STATES

On 13 March 2020, the European Commission submitted a proposal to the European Parliament, aiming, notably, to modify the regulation on the European Regional Development Fund and the regulation on the European Maritime and Fisheries Fund.

The Commission suggested mobilizing EUR 37 billion to fight the Coronavirus crisis, waiving its obligation to request the reimbursement of structural fund pre-financings. The sum being made available to Member States includes EUR 8 billion from the EU budget and EUR 27 billion from EU structural funds.

On 26 March 2020, MEPs adopted the Commission's proposals on the use of the European Solidarity Fund and the mobilization of the sum of EUR 37 billion under the cohesion policy, in order to help Member States tackle the consequences of the Covid-19 health crisis. These funds are intended for health systems, SMEs, employment markets and other vulnerable sectors in EU Member States' economies.

The Council of the EU approved these measures on 30 March.

12. CONTROL OF DIRECT FOREIGN INVESTMENTS

On 25 March 2020, the European Commission published orientations relating, mainly, to direct foreign investment and the protection of strategic European assets.

This communication should attract the attention of all companies working in France whose activity is considered strategic in accordance with the French Monetary and Financial Code and particularly those whose stock-exchange price is subject to high volatility or is under-valued because of the stock market crisis resulting from the Covid-19 pandemic.

In the current context, these companies are particularly likely to be the target of transactions which could, immediately or over time, take the composition of their majority ownership in an undesirable direction.

So that strategically important companies for Member States can avoid undergoing such changes in ownership, the Commission recalled that, in accordance with EU law, Member States are able to limit direct foreign investments that create such risks.

In particular, it noted that health emergency situations are among the risks to security and public order covered by regulation n°2019/452 of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union ("the 2019 Regulation"), which will enter into force on 11 October 2020.

The Commission is thus asking Member States to fully implement their supervisory mechanisms for direct foreign investments. It recommends that they operate with the aim of ensuring that the targets of controlled investments remain strong and able to continue to meet the needs of EU citizens in order to safeguard, broadly speaking, the European economy's strategic capacities. Member States are also invited to monitor each investment in terms of its potential consequences for the Union as a whole.

France now has the tools to meet this demand and thus protect strategic French companies likely to be the targets of undesirable direct foreign investments.

French rules were overhauled in 2019. Certain equity operations or acquisitions, carried out by foreign investors or French investors abroad and pertaining to companies established under French law (including societates Europaeae) which perform certain strategic activities, are required to be submitted to the Minister of the Economy for prior authorisation. The list of activities deemed strategic under the French regulation on foreign direct investments was extended so as to adapt to contemporary issues.

Among others, activities relating to public health, the fight against the illicit use of pathogenic or toxic substances, energy and water supply, transport network operations and services, electronic communications and certain agricultural products are considered strategic activities. Companies which are unable to establish their status in terms of this regulation may file a request for an opinion with the Minister for the Economy.

The Minister for the Economy can deny authorisation or make it subject to certain conditions. These conditions can aim, for example, to ensure the continuity and security, on domestic territory, of protected activities, or to ensure that the knowledge and know-how of the target company are retained to stop them from being appropriated. The Minister also has a power of injunction.

Lastly, the Minister can implement precautionary measures, such as suspending, restricting or temporarily prohibiting the choice to dispose of all or part of assets relating to strategic activities.

13. SUSPENSION OF DIVIDEND PAYOUTS AND SHARE BUYBACKS

In a recommendation on 7 March 2020, the European Central Bank (ECB) advised credit establishments not to pay out dividends to their shareholders until 1 October 2020. This recommendation also extends to share buyback programmes.

On 30 March, the French Prudential Supervision and Resolution Authority (ACPR) reiterated the EU's recommendation and invited the credit institutions under its supervision to not pay out any dividends or buy back any shares, until 1 October 2020.

The ECB and ACPR recommendations can be renewed, as both institutions have reserved the right to reexamine the situation in order to establish whether the suspension of dividends is desirable beyond 1 October.

14. COMMMISSION SUPPORT FOR EMPLOYMENT PLANS

On 2 April 2020, the European Commission proposed the creation of a EUR 100 billion solidarity instrument named "SURE". The funds mobilized by this instrument would be aimed at supporting partial unemployment mechanisms and similar measures, so as to help states protect jobs, workers and the self-employed against the risk of layoffs and income loss.

The Eurogroup adopted this proposition on 9 April 2020, for a duration not to exceed that of the health crisis. The scope of this instrument has been extended to healthcare spending. The measure still needs to be approved by the European Parliament and the Council of the EU. In this connection, the European Parliament will decide on this proposition in an extraordinary session on 16 and 17 April 2020.

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