

COVID-19: LATEST UPDATE ON UK AND EU FINANCIAL REGULATORY ISSUES

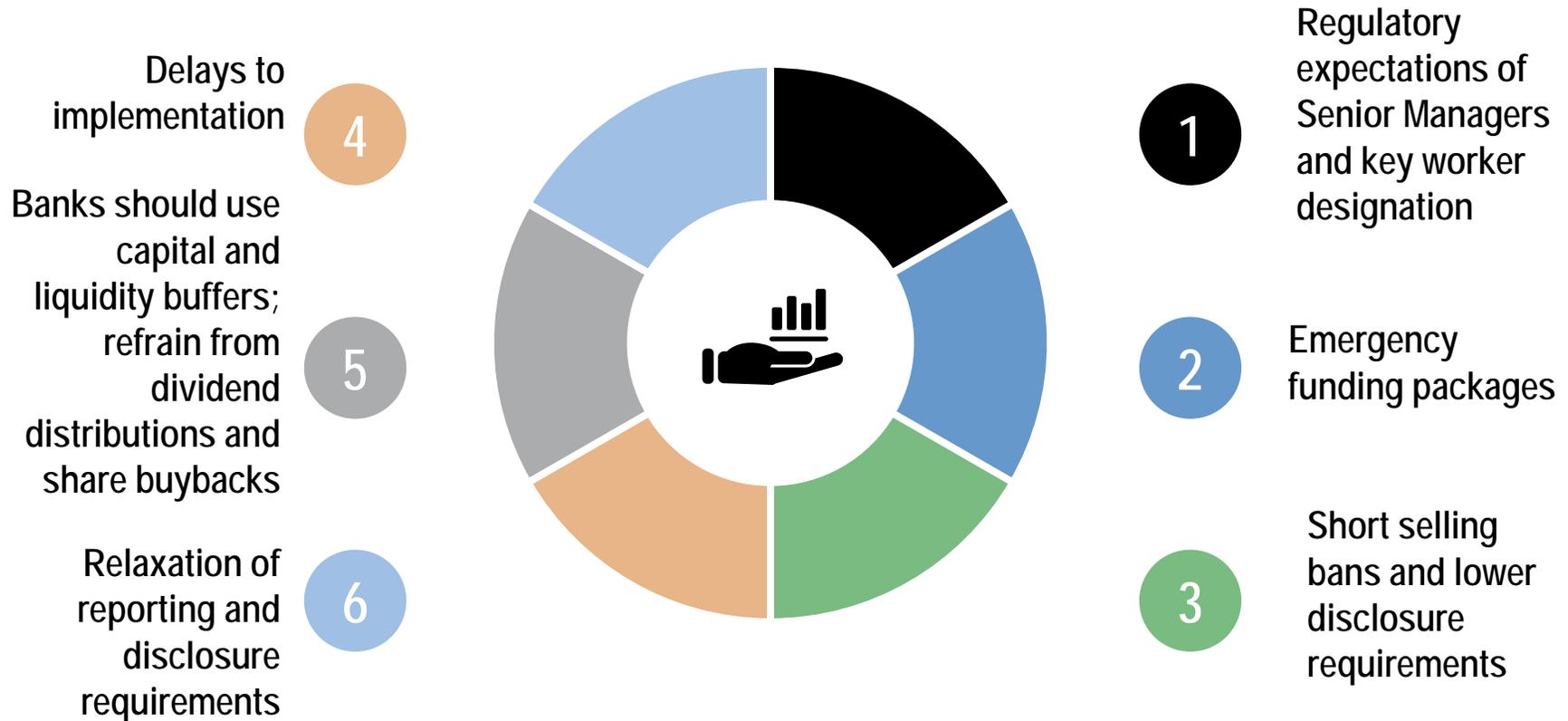
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AGENDA

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- 2 FUNDING PACKAGES
- 3 SHORT SELLING
- 4 DELAYED IMPLEMENTATION
- 5 PRUDENTIAL
- 6 REPORTING

COVID-19 REGULATORY RESPONSE



1. SENIOR MANAGERS AND KEY WORKERS

COVID-19 REGULATORY RESPONSE - UK

Senior Managers



- Firms are not expected to have a single “coronavirus” function with responsibility for all aspects of the firm’s COVID-19 response; the main thing is to allocate responsibilities so that the risks posed to the firm are appropriately managed
- The CEO (or most relevant senior management) should take responsibility for identifying key workers and firms should consider contingency plans for reallocating responsibilities in the event of absent Senior Managers

COVID-19 REGULATORY RESPONSE - UK

Senior Managers

Statement of Responsibilities (SoRs)

12-week rule

Dual-regulated firms

- Firms to update their SM&CR SoRs only as soon as reasonably practicable and accept that this may take longer than usual

Solo-regulated firms

- Firms not expected to provide updated SoRs to the FCA where changes are temporary, made in direct response to COVID-19 and the firm expects to revert to its previous arrangements
- Internal records should be updated

Dual-regulated firms

- The FCA and PRA are considering whether to extend the 12-week rule
- Firms may use the 12-week rule, but should keep records of any temporary allocations and notify the FCA and PRA via email or telephone

Solo-regulated firms

- The FCA modification by consent of the “12-week rule” allows a Senior Manager to be appointed on a temporary basis for up to 36 weeks
- Allows firms to allocate an absent Senior Manager’s Prescribed Responsibilities to the individual covering the role

COVID-19 REGULATORY RESPONSE - UK

Senior Managers

Furloughing

Dual-regulated firms

- Certain SMFs to continue to operate, where relevant to the firm, and furloughed only as last resort: CEO, CFO, Chair, Head of Overseas Branch
- Individuals carrying out other SMFs may be furloughed, but firms must consider risks
- All decisions to furlough to be notified to both regulators (email or telephone)
- Firms must document any reallocation of furloughed responsibilities in Statements of Responsibilities, Management Responsibility Maps and internal documents

Solo-regulated firms

- Firms may choose to furlough Senior Managers, but the furloughed individual will retain their approval as a Senior Manager and the firm must continue to ensure the individual is fit and proper for that SMF if the intention is that they will eventually return to it
- The responsibilities of the furloughed Senior Manager should be reallocated to another Senior Manager or temporarily to another individual in accordance with the 12-week rule
- Those performing required functions should only be furloughed as a last resort and should be replaced until their return

COVID-19 REGULATORY RESPONSE - UK

Senior Managers

Solo-regulated firms: FCA guidance

- Relevant Senior Managers or equivalent persons are responsible for prioritising which of their firm's employees cannot work from home and need to travel in to an office or business continuity site to perform their role
- One Senior Manager must be appointed to oversee a firm's lending activities to SMEs; even though lending itself is unregulated, the SMR applies to **all** of a firm's activities
 - CEOs and board expected to challenge Senior Manager and also collect information on a firm's lending activities to SMEs to ensure SMEs are treated fairly

Dual-regulated firms: PRA & FCA joint guidance

- Certification of fit and proper employees: firms should continue to assess whether staff are fit and proper to conduct their functions, although the FCA and PRA accept that standard certification processes and policies may need to be adjusted

COVID-19 REGULATORY RESPONSE - UK

Key worker designation

- U.K. Government: “Key workers” in financial services firms are described by the Government as staff “needed for essential financial services provision (including but not limited to workers in banks, building societies and financial market infrastructure)”
- Key workers are important to employers – schools open for children of key workers during lockdown and key workers prioritised for COVID-19 testing
- PRA/FCA guidance: a key worker fulfils a role which is necessary for the firm to continue to provide essential daily financial services to consumers, or to ensure the continued functioning of markets
- PRA/FCA recommended steps:
 - Identify the activities, services or operations which, if interrupted, are likely to lead to the disruption of essential services to the real economy or financial stability
 - Identify the individuals that are essential to support these functions
 - Identify any critical outsource partners who are essential to continued provision of services, even where these are not financial services firms
- PRA/FCA expects the number of financial services workers required to be physically present should be considerably smaller than in a “business as usual” scenario and every possible step should be taken by employers to facilitate workers being able to operate from home

COVID-19 REGULATORY RESPONSE - UK

Key worker designation

PRA/FCA Guidance: In-scope

- Overall management of the firm, e.g., those that fall within the SMR
- Operation of trading venues and other critical elements of market infrastructure
- Running of online services and processing
- Running of branches, and provision of essential customer services, e.g., dealing with customer queries, client money or access to cash and payment services
- Facilitation of corporate and retail lending and administering the repayment of debt
- Risk management, compliance and audit functions (and any other functions required for firms to comply with customer needs and regulatory obligations)
- Support functions for the above, such as finance and IT staff, but only where they cannot provide their services from home

FCA Guidance: Out of scope

- Financial advisers
- Staff able to securely trade shares and financial instruments from home
- Business support staff who cannot provide their services from home or are looking after specialist equipment or technology
- Claims management companies and sellers of non-essential goods and credit

Grey areas

- Outsourced service providers may be categorised as “support functions”, depending on how critical the services are to firms
- Key external service providers of support, such as law firms and accountancy firms, may also fall within “support functions”, depending on the circumstances
 - There is Law Society guidance on external lawyers, who can flip in or out when providing certain services, e.g., attending court or preparing for court proceedings
 - Core in house GC and compliance functions are likely key functions
- Secondment arrangements

COVID-19 REGULATORY RESPONSE – EU AND UK

Conduct

EBA & ESMA

- Firms must continue to act in best interests of consumers, particularly when engaging with consumers on temporary loans and mortgages
- Firms must continue to comply with all legal and regulatory requirements, particularly the information disclosure rules (NB = any potential charges and costs) and the requirement for T&Cs to be transparent and clear
- Reminds firms to continue to comply with the MiFID II conduct requirements, in particular when dealing with new retail customers, such as acting fairly and honestly, suitability and appropriateness, product governance and disclosures

U.K. FCA Concerns on treating customers fairly: insurance and private equity raisings

- Reminds firms of their regulatory obligations to treat customers fairly, manage conflicts of interest, comply with the individual conduct rules under the SM&CR and appropriately handle inside information, e.g., specific disclosure and TCF measures on travel and motor insurance
- Firms must review current systems and controls to ensure that they are appropriate for ensuring the proper treatment of clients, the identification and mitigation of conflicts of interest, and the handling of inside information
- FCA “will not hesitate to take action” if it receives further evidence of firms not in compliance
- Firms should also proactively manage increased cyber security risks

2. FUNDING PACKAGES

EMERGENCY FUNDING MEASURES – ECB (1)

Collateral Easing Measures

To facilitate availability of eligible collateral for Eurosystem counterparties to participate in liquidity operations, ECB has:

- Expanded additional credit claims frameworks
- Lowered the level of the non-uniform minimum threshold for domestic credit claims from €25,000 to €0
- Increased the maximum share of unsecured debt instruments issued by any other banking group in a credit institution's collateral pool from 2.5% to 10%
- Waived the minimum credit quality requirements for Greek debt instruments as eligible collateral in Eurosystem credit operations
- Reduced collateral valuation haircuts by fixed factor of 20%
- Agreed to grandfather until Sept 2021 the eligibility of marketable assets used as collateral that fulfilled credit quality requirements on 7 April 2020 in the event of a credit ratings downturn

Pandemic Emergency Purchase Programme

- €750bn temporary asset purchase programme introduced for private and public sector securities
- Purchases will be conducted until end-2020
- Includes all asset categories eligible under ECB's existing asset purchase programme (e.g., corporate sector, public sector, asset-backed securities and covered bonds) and expands eligible assets under corporate sector purchase programme to non-financial paper (so all commercial paper of sufficient credit quality is eligible)
- Collateral standards under purchase programmes have been eased (e.g., through expanded scope of additional credit claims and waiver of eligibility requirements for Greek debt instruments)

EMERGENCY FUNDING MEASURES – ECB (2)

Targeted Longer-Term Refinancing Operations (TLTROs)

To facilitate ongoing access of firms and households to bank credit, the following modifications have been made to ECB's TLTRO III:

- Maximum total amount that counterparties can borrow will be raised from 30% to 50% of eligible loans as at 28 February 2019 for all future TLTRO III operations
- From 24 June 2020 to 23 June 2021, the interest rate on all TLTRO III operations will be at least 50 bps below average rate for Eurosystem's main refinancing operations for that period
- The lending performance threshold required for further reductions to the interest rate on TLTRO III operations has been reduced from 2.5% to 0% over benchmark net lending for the period from 1 March 2020 to 31 March 2021
- Banks that don't meet the 0% lending performance threshold remain subject to the original rates evaluated for the period from 1 April 2019 to 31 March 2021, but the lending threshold to obtain more favourable interest rates on the basis of this longer assessment period will be lowered from 2.5% to 1.15%

Longer-Term Refinancing Operations (LTROs) and Pandemic Emergency Longer-Term Refinancing Operations (PELTROs)

Additional longer-term financing operations have been launched alongside the ECB's modified TLTRO III:

- On 12 March 2020, ECB announced a series of bridge LTROs to be allotted on a weekly basis between March to June 2020, all maturing on 24 June 2020 (tying in with the 24 June settlement date of the next TLTRO III series)
- On 30 April 2020, ECB announced an additional series of 7 PELTROs designed to provide a backstop for money markets after the expiry of bridge LTROs
- Interest rates on PELTROs will be 25 bps below average rate for Eurosystem's main refinancing operations over the life of the PELTRO
- PELTROs will be allotted on following dates through 2020 and will have decreasing tenors:
 - 20 May (maturing 30 Sept 2021)
 - 22 June (maturing 30 Sept 2021)
 - 5 Aug (maturing 30 Sept 2021)
 - 2 Sept (maturing 26 Aug 2021)
 - 7 Oct (maturing 26 Aug 2021)
 - 4 Nov (maturing 29 July 2021)
 - 2 Dec (maturing 29 July 2021)

EMERGENCY FUNDING MEASURES – UK: BANKS

Bank of England (BoE)

- **Bank Rate:** BoE has cut Bank Rate to historic low of 0.1%
- **Term Funding Scheme (TFSME):** offers four-year funding of at least 10% of participating banks' real economy lending stock at interest rates at, or close to, Bank Rate
 - Additional funding available for banks that increase their lending at, or close to, Bank Rate and for banks that lend to small- and medium-size enterprises (SMEs)
 - TFSME participants will be able to extend the term of their cheap TFSME funding to align with the 6-year terms of loans made under HM Treasury's Bounce Back Loan Scheme
 - Eligible banks are those that participate in BoE's Sterling Monetary Framework and are signed up to Discount Window Facility
- **Contingent Term Repo Facility (CTRF):** allows participating banks to borrow BoE cash in exchange for less liquid assets
 - BoE commenced CTRF operations on a weekly basis from 24 March 2020; has announced operations will continue on a weekly basis through May 2020
 - Cash lent for periods of one or three months
 - CTRF runs alongside BoE's usual sterling market operations (e.g., Indexed Long-Term Repo operations and Discount Window Facility)

EMERGENCY FUNDING MEASURES – UK: SME/INNOVATIVE FIRMS

Facility	Lender/Purchaser, Guarantor, Funder	Purpose	Eligible Issuer/Borrower/Firm	Eligible Asset/Collateral
Innovative business fund (Part 1): £500m Future Fund (launching in May 2020)	Lender: U.K. Government and private investors	U.K. Government will provide loans of between £125,000-£5m (matched by private investors) to U.K.-based high growth companies	Borrowers: U.K. registered unlisted companies that have raised at least £250,000 in equity investment in the past five years	TBC
Innovative business fund (Part 2): £750m Innovate UK fund (launching in May 2020)	Lender/Funder: Innovate UK	Innovate UK will make up to £750m available in grants and loans to UK Innovate customers and up to 1,200 non-customer innovative firms	Borrowers: existing customers of UK Innovate and up to 1,200 non-customer innovative firms	TBC
Coronavirus Business Interruption Loan Scheme (CBILS)	Lender: Accredited lenders of British Business Bank Guarantor: U.K. Government will provide 80% guarantee and pay interest and fees for first 12 months	Accredited lenders will provide up to £5m in term loans, overdrafts, invoice or asset finance to SMEs	Borrowers: U.K.-based SMEs with an annual turnover of up to £45m Borrowers who have taken out CBIL worth £50,000 or less can switch to BBLs until 4 Nov 2020 (see below)	Insufficient security not a condition to access scheme; lenders cannot demand personal guarantees for facilities under £250,000
Bounce Back Loan Scheme (BBLs)	Lender: Accredited Lenders of British Business Bank Guarantor: U.K. Government will provide 100% guarantee	Accredited lenders will provide loans of £2,000 - 25% of business' turnover (up to max. of £50,000) to U.K. SMEs with no repayments, fees or interest for first 12 months	Borrowers: U.K. SMEs who have been negatively affected by coronavirus and were not classified as an "undertaking in difficulty" on 31 December 2019; not available to banks, insurers or public sector bodies	Lenders not permitted to benefit from personal guarantees or seek recoveries against borrower's personal assets

EMERGENCY FUNDING MEASURES – UK: LARGE COMPANIES

Facility	Lender/Purchaser, Guarantor, Funder	Purpose	Eligible Issuer/Borrower/Firm	Eligible Asset/Collateral
Coronavirus Large Business Interruption Loan Scheme (CLBILS)	<p>Lender: Accredited lenders of British Business Bank</p> <p>Guarantor: U.K. Government will provide 80% guarantee</p>	Accredited lenders will provide between £25m-£50m in term loans, overdrafts, invoice or asset finance to larger businesses with annual turnover of between £45m-£500m	<p>Borrowers: Businesses with annual turnover of over £45m and have been adversely impacted by coronavirus</p> <p>Not available for businesses that have received a facility under BoE's Covid-19 Corporate Financing Facility or banks, insurers and building societies</p>	No personal guarantees are permitted for facilities under £250,000; personal guarantees may be given for facilities of £250,000 and over but claims cannot exceed 20% of losses after all other recoveries have been applied
COVID-19 Corporate Financing Facility (CCFF)	<p>Purchaser: Bank of England</p> <p>Guarantor: Required if issuer is not group's primary entity and is not investment grade</p>	BoE will purchase commercial paper from eligible companies to provide bridging support to companies experiencing funding difficulties	Issuer: Companies (typically investment grade) that make a material contribution to the U.K. economy; not available to banks, building societies, leveraged investment vehicles/groups predominantly active in business subject to financial regulation	Asset: Commercial paper issued by eligible companies

EMERGENCY FUNDING MEASURES – UK

CBILS and BBLs - conduct

FCA has announced:

- If firms comply with CBILS requirements, they are not expected to comply with FCA Handbook CONC 5.2A.4-34 (on conducting reasonable assessments of customers' creditworthiness) where lending is regulated
- The FCA statement does not expressly state that the same applies to firms complying with BBLs requirements. However, it does state that other than for loans made under either CBILS or BBLs, firms must continue to carry out creditworthiness assessments for all other regulated lending (i.e., comply with the whole of CONC 5.2A)
- Individuals' compliance with CBILS or BBLs requirements will be regarded as compliance with FCA Handbook individual conduct rules (under the SM&CR) on assessments of creditworthiness and affordability

(FCA website, "Statement on the U.K. CBILS and BBLs")

EMERGENCY FUNDING MEASURES – UK

CBILS, CLBILS and BBLIS – prudential treatment

PRA has stated:

- Government guarantees under the CBIL and CLBIL Schemes would appear to be eligible for treatment as unfunded credit risk mitigation for CRR purposes, but notes that this guidance does not provide an exhaustive description of the prudential requirements applicable to such loans

(PRA Statement on the regulatory treatment of the U.K. CBILS and CLBILS)

- Government guarantees under BBLIS would appear to be eligible as unfunded credit risk protection
- PRA is offering modification by consent to exclude BBLIS loans (and similar EEA or ECB schemes) from leverage ratio total exposure measures under Leverage Ratio Part of PRA Rulebook

(PRA Statement on credit risk mitigation eligibility and leverage ratio treatment of loans under the Bounce Back Loan scheme)

EMERGENCY FUNDING MEASURES – UK: REGULATORY ISSUES

Financial Services and Markets Act 2000 (Regulated Activities) (Coronavirus) (Amendment) Order 2020 came into force on 4 May 2020, providing:

- Credit agreements of £25,000 or less under BBLs are “exempt agreements” for purposes of Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (“RAO”) and therefore not subject to consumer credit regulatory regime
- Carrying out debt collecting in relation to a BBLs activity is a specified activity under Art. 39F RAO
- Lenders who had permission to conduct debt collecting activities under Art. 60B(2), RAO and who now enter into a BBLs loan will be permitted to conduct debt collecting in relation to the BBLs loan in accordance with Art 39F(1)

3. SHORT SELLING

COVID-19 REGULATORY RESPONSE - EU

Short selling – lower threshold for disclosing short positions



- Effective since 16 March 2020 for three months
- Net short position holders must notify the relevant national regulator of any net short position of 0.1% of the issued share capital of a company and of each 0.1% above that threshold
- All holders of net short positions in shares traded on an EU regulated market (i.e., exchange)
- Applies to natural or legal persons, regardless of where they are located
- It is not necessary to notify existing positions above the new lower threshold which were not previously notifiable
- Does not apply to:
 - Market making activities
 - Shares admitted to trading on an exchange where the principal venue for the trading of the shares is located in a third country
 - A net short position for the carrying out of a stabilisation under the Market Abuse Regulation
- *(ESMA Decision of 16 March 2020)*

COVID-19 REGULATORY RESPONSE - EU

Short selling - bans

France

- Ban on creating or increasing any short position of shares admitted to trading on French trading venues (such as Euronext Paris, Euronext Growth Paris and Euronext Access Paris), ending 18 May 2020

Italy

- Ban on taking or increasing net short positions of all shares admitted for trading on the Mercato Telematico Azionario (“MTA”), the Italian regulated stock market, ending 18 June 2020

Spain

- Ban on short selling of shares admitted to Spanish trading venues (such as Bolsa De Madrid, S.A., Bolsa De Barcelona, S.A., Bolsa De Valencia, S.A., Bolsa De Bilbao, S.A. and Mercado Alternativo Bursátil, S.A.), ending 18 May 2020

Belgium

- Ban on short sales for shares admitted to trading on Belgian trading venues (Euronext Brussels and Euronext Growth), as well as related instruments, ending 18 May 2020

Greece

- Ban on short sales in respect of all shares admitted to trading on the Athens Stock Exchange as well as related instruments, ending 18 May 2020

Austria

- Ban on short sales in respect of all shares admitted to trading on the Regulated Market of the Vienna Stock Exchange (“Wiener Börse”) for which the FMA is the competent authority, ending 18 May 2020

COVID-19 REGULATORY RESPONSE - EU

Short selling - bans

Exemptions

- Market making exemption from all bans
- Other specific exemptions available

Germany

- BaFIN clarification on the scope of the bans
- Instruments related to the indices Euro STOXX 50®, STOXX® Europe 600, MSCI Europe, MSCI EMU and Euro STOXX® FOOD & BEVERAGE are exempt from the short-selling prohibitions because the restrictions apply to index-related instruments only if the shares covered by the prohibitions exceed the respective defined thresholds expressed as a percentage of their index weighting
- These instruments are not covered by the prohibitions announced by the other regulators

4. DELAYED IMPLEMENTATION

COVID-19 REGULATORY RESPONSE - EU

Securities Financing Transactions

Reporting Date	Counterparty Type
13 April <u>13 July</u> 2020	Banks and investment firms <ul style="list-style-type: none">• Delay applies to SFTs that are subject to the backloading requirement (<i>ESMA statements of 26 and 19 March 2020</i>)• FCA has confirmed it will follow ESMA's regulatory forbearance
13 July 2020	CCPs and CSDs
12 October 2020	Other Financial Counterparties
11 January 2021	Non-Financial Counterparties
<p>Financial Counterparties - EU established and authorised banks, investment firms, insurance companies, UCITS and their managers, AIFs by EU authorised or registered AIFMs, occupational pension schemes, CCPs, CSDs, and third country entities which would be FCs if they were established in the EU</p> <p>Non-financial Counterparties - including third country counterparties which would be non-financial counterparties if established in the EU</p>	

COVID-19 REGULATORY RESPONSE - GLOBAL

Basel Committee on Banking Supervision

- Delays to Implementation
 - One-year deferral to 1 January 2023, from 1 January 2022 of:
 - Revised leverage ratio framework and G-SIB buffer
 - Revised standardised approach for credit risk
 - Revised internal ratings based approach for credit risk
 - Revised operational risk framework
 - Revised credit valuation adjustment risk framework
 - Output floor (the transitional arrangements that were originally intended to be implemented to 1 January 2027 have been extended to 1 January 2028)
 - Revised Pillar 3 disclosure framework
 - One-year delay of implementation of the revised methodology for the assessment of G-SIBs, from 2021 to 2022
 - No deferral of the implementation of the higher loss absorbency requirement, due to come into force on 1 January 2023
- Technical guidance
 - For the capital treatment of loans subject to COVID-19-related government guarantees and payment moratoriums
 - On the impact of COVID-19 upon expected credit loss accounting

(Basel Committee press release, 3 April 2020)

COVID-19 REGULATORY RESPONSE - DERIVATIVES

Basel/IOSCO

- One-year deferral of Initial Margin requirements for non-centrally cleared derivatives for covered entities (financial institutions and systemically important non-FIs) belonging to a group whose aggregate month-end average notional amount (AANA) of non-centrally cleared derivatives exceeds:
 - €8bn: from 1 September 2022; instead of from 1 September 2021
 - €50bn: from 1 September 2021; instead of from 1 September 2020
 - *(Basel/IOSCO Statement, 3 April 2020)*

EU

- ESAs have submitted revised final draft RTS to the European Commission (*ESA Final Report, EMIR RTS on various amendments to the bilateral margin requirements in view of the international framework, 4 May 2020*)

U.K. FCA

- Considering how to implement the changes (*FCA statement, 8 April 2020*)



COVID-19 REGULATORY RESPONSE - EU

Prudential

Capital Requirements Regulation and CRR 2

Leverage ratio buffer requirement for G-SIBs (introduced by CRR2 in Europe): delayed from 1 January 2022 to 1 January 2023

- Proposal to delay in EU by amendment to CRR2: *Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards adjustments in response to the COVID-19 pandemic (COM(2020) 310 final), 28 April 2020* (“EC Proposal to amend CRR and CRR2”)
- Delayed by Basel committee: *Basel Committee statement, 27 March 2020*

Prudent valuation

- To mitigate the impact on additional valuation adjustments (AVAs), the EBA is proposing to amend the RTS on prudent valuation (Delegated Regulation (EU) No 101/2016), to increase the aggregation factor applicable to the core approach from 50% to 66% until 31 December 2020, with aim of it applying for the 30 June 2020 COREP reporting (*EBA final draft RTS on prudent valuation under Article 105(14), CRR, 22 April 2020*)
- AVAs aim to ensure that banks prudently value their fair-valued financial instruments
- Prudent value is the value at which a bank is 90% confident that it will exit a position based on the applicable market conditions at the time of the assessment
- Extreme volatility in the markets has affected the AVAs and had an excessive impact on aggregated AVAs because banks using the core approach to compute, for market price uncertainty, close-out costs and model risk category-level AVAs, individual AVAs for separate valuation exposures, which are then aggregated to provide total category-level AVA based on the formula in the annex to the RTS, using the existing aggregation factor of 50%
- The increase in the aggregation factor is intended to mitigate the extreme procyclical effect of the current prudent valuation aggregation
- EBA’s draft amendment submitted to European Commission on 22 April 2020

Solvency/Insurance - Various reporting delays announced by PRA (not covered in detail here)

COVID-19 REGULATORY RESPONSE - EU

EBA - proposed legislative delays

- Fundamental Review of the Trading Book reporting requirements were due to start from Q1 2021
 - On 4 May 2020, the EBA submitted the related draft ITS to the European Commission with a starting date of 1 September 2021
 - Note: change dependent on final version of ITS
 - EBA recommending the European Commission implement the same delay in its delegated act on market risk

5. PRUDENTIAL

COVID-19 REGULATORY RESPONSE - EU

Prudential

Proposed amendments to CRR and CRR2

- **NPLs guaranteed or counter-guaranteed by the public sector:** export-credit-type risk weighting extended to public sector loans granted in response to COVID-19
 - Note: guarantees must follow state aid rules to qualify
 - Temporary seven-year measure
- **Exclusion of central bank debt from leverage ratio:** discretion to disallow this from 28 June 2021 under CRR2; proposal to change this to be a one-off assessment at the point of draw down
- **Software asset deduction exemption:** this is an exemption from the requirement to deduct certain software assets from CET1 capital (Article 2(18), CRR2); the provisions of which are effective 12 months after related RTS come into effect
 - Proposed that the exemption would be available earlier; from the date the RTS enter into force
- **Lower capital cost for retail loans:** CRR2 introduced:
 - Lower risk weighting of loans granted by banks to pensioners or employees with a permanent contract against the unconditional transfer of part of the borrower's pension or salary
 - Changes to the SME supporting factor and the new infrastructure supporting factor
 - Proposal to implement earlier than planned under CRR2, changing the application date from 28 June 2021 to 27 June 2019

EC Proposal to amend CRR and CRR2, 28 April 2020

COVID-19 REGULATORY RESPONSE - EU

Prudential

Accounting

- European Commission Communication confirming the guidance given by European authorities and international bodies on the flexibility in the EU's current accounting rules (*Commission Interpretative Communication on the application of the accounting and prudential frameworks to facilitate EU bank lending - Supporting businesses and households amid COVID-19 (COM(2020) 169 final), 28 April 2020*)
- IFRS 9 requires banks to make judgement calls on expected credit losses (ECLs), based on information available
- In the current situation, there is not much reasonable and forward-looking information available
- Banks must continue to identify where borrowers might experience financial difficulties that could impact their capacity to repay their loans in the longer term
 - Banks' assessment of a significant increase in credit risk should be based on the remaining lifetime of the financial assets
- It is unlikely that COVID-19 temporary relief measures, such as private or statutory moratoria, constitute substantial "modifications" under IFRS 9
- Banks should provide "insightful" disclosures on the determination of ECLs under IFRS 9, including information on the downside scenarios
- Banks encouraged to implement the IFRS 9 transitional arrangements within CRR to reduce the impact of IFRS 9 ECL provisioning on banks' regulatory capital

COVID-19 REGULATORY RESPONSE - EU

Prudential

Prudential rules on classifying NPLs

- European Commission Communication confirms the guidance given by European authorities and international bodies on the flexibility in the EU's current prudential requirements on the classification of non-performing loans
 - The EU prudential rules do not require a bank to automatically consider an obligor in default when it calls on a guarantee
 - The temporary COVID-19 public and private moratoria schemes are not borrower-specific and should not lead to automatic reclassification of a loan as an NPL
 - EBA guidelines of 2 April 2020 on payment moratoria
 - Set out the conditions public or private payment moratoria do not trigger the classification as forbearance
 - Confirm that banks should continue to apply a risk-based approach to assessing unlikelihood to pay

COVID-19 REGULATORY RESPONSE - EU

EBA

- EBA “requirements”
 - Banks to abstain from dividend distribution or share buybacks; firms should ensure variable remuneration levels are conservative (*EBA statement on dividends distribution, share buybacks and variable remuneration, 31 March 2020*)
- EBA suggested relaxations subject to relevant national authority supervisory decisions
 - SREP process
 - Operational relief for certain elements of a recovery plan (not as relevant in the current situation) for firms with developed recovery plans, in the absence of significant changes since the last submission of the recovery plan or of material deficiencies identified
- EBA guidance
 - Legislative and non-legislative moratoria on loan repayments under CRR that includes the prudential treatment of default and the classification of regulatory forbearance measures
 - The EBA has also published a statement providing guidelines on how this Guidance applies to securitisations
 - The application of IFRS 9
 - Market risk
 - The importance of recovery planning, in particular, being up to date on the latest risks to a firm and the financial situation of a firm

(EBA statements of 12, 25, 31 March and 2 and 22 April 2020)

COVID-19 REGULATORY RESPONSE - UK

FPC and PRA– capital

- The Financial Policy Committee has reduced the U.K. countercyclical capital buffer from 1% to 0% of banks' exposures to U.K. borrowers with immediate effect
 - The FPC expects the 0% rate to apply for at least 12 months and any subsequent increase will not take effect until at least March 2022 (*Financial Policy Summary and Record of the Financial Policy Committee Meetings on 9 and 19 March 2020, published 24 March 2020*)
- PRA's decision to maintain the systemic risk buffer (SRB) rates applicable to ring-fenced bodies at the rate set in December 2019; the SRB rates will be re-assessed in December 2021 and the decision taken then will take effect in January 2023 (*PRA decision on Systemic Risk Buffer rate, 9 April 2020*)
- PRA modification by consent of the calculation of the total exposure measure of the Leverage Ratio. Firms that apply for and obtain the modification will be required to calculate their exposure value of regular way purchases and sales awaiting settlement according to the incoming provisions of the CRR. CRR was amended in June 2019 and, subject to certain exceptions, the changes brought in by CRR2 are effective from 28 June 2021. The PRA is allowing firms to adopt these specific changes in advance of the application date (*PRA statement and Modification by Consent, 9 April 2020*)

COVID-19 REGULATORY RESPONSE - UK

BoE and PRA – capital and MREL

Amendments to capital and MREL

- All Pillar 2A requirements are being set as a nominal amount, instead of a percentage of total Risk Weighted Assets (RWAs)
 - Applies to CRDIV firms
 - Reduces Pillar 2A
 - Reduces the threshold at which firms are subject to maximum distributable amount (MDA) restrictions, as a share of a firm's RWAs in the capital stack if RWAs increase
 - Applies to firms in the 2020 (automatically) and 2021 (on voluntary application) SREP
- 2021 MRELS to reflect this Pillar 2A change
- For firms that need to transition to a higher MREL (firms not currently subject to a leverage-based capital requirement, but which subsequently become subject to one), will be given at least 36 months after that requirement takes effect to meet the higher MREL

COVID-19 REGULATORY RESPONSE - UK

BoE and PRA – resolution

Amendments to resolution measures

- Extension by a year of the first reports and public disclosures on resolution preparations of major U.K. banks and building societies
 - First reports due to the PRA by October 2021
 - Public disclosures to be made by June 2022
- PRA to consult “in due course” on amendments to the resolvability assessment framework
- Resolution pack information under PRA Supervisory Statement SS19/13 ‘Resolution Planning’ now due by the end of 2022, unless the PRA notifies individual firms otherwise
 - Extends the existing extension of end 2020
- Valuation capabilities to support resolvability extended by three months to 1 April 2021
 - Other deadlines relevant to resolvability remain 1 January 2022

COVID-19 REGULATORY RESPONSE - UK

BoE and PRA – general prudential

Other prudential-related measures

- Planned Climate Biennial Exploratory Scenario exercise delayed until at least mid-2021
 - Other work related to managing climate-related risks continues, for example, in summer the PRA will issue follow-on guidance on enhancing firms' approaches to managing the financial risks from climate change
- PRA confirmation firms are not expected to update their SVAR 12-month period during the current period of financial market stress, unless a firm's current period no longer represents a significant period of stress for the firm's portfolio (e.g. due to a material change in risk profile).
 - The CRR requires firms to review the choice of historical data at least annually
 - PRA usually expects quarterly reviews
 - Firms permitted to delay this review until December 2020 (in line with EBA guidance)

6. REPORTING

COVID-19 REGULATORY RESPONSE – EU MIFID II

Telephone recording requirements

ESMA

- Where a firm is unable to record calls, as required by MiFID II, alternative steps should be put in place to mitigate the risk posed by the lack of the recording
 - Alternatives must be temporary and firms are expected to reinstate telephone recording as soon as possible
- Written minutes or notes of telephone conversations
- Prior information to clients on impossibility to record the call / written note
- Enhanced monitoring and ex-post review of relevant orders and transactions
- *(ESMA statement, 20 March 2020)*

U.K. FCA

- FCA expects firms to continue recording calls
- Where recording is not possible, firms should inform the FCA and consider what steps they could take to mitigate the risks
- *(FCA website, “Coronavirus (COVID-19): Information for Firms”)*

COVID-19 REGULATORY RESPONSE – EU MIFID II

Transparency calculations

ESMA – non-equity transparency calculations

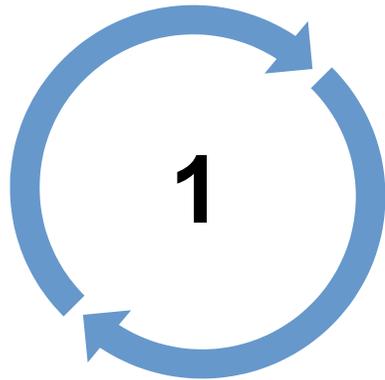
- Postponement of the publication of the annual transparency calculation for derivatives, emission allowances and structured finance products from 30 April to 15 July 2020 and their application from 1 June to 15 September 2020
 - The transitional transparency calculations will continue to apply until 14 September 2020 (inclusive)
- The publication and application of the annual transparency calculations for bonds remain unchanged; the new thresholds will be applicable from 1 June 2020
- Also postponed; the publication date for the quarterly systematic internaliser data for non-equity instruments other than bonds, from 1 May 2020 to 1 August 2020
- The mandatory systematic internaliser regime for derivatives, emission allowances and structured finance products will apply from 15 September 2020
- *(ESMA statement, 9 April 2020)*

ESMA – equity transparency calculations

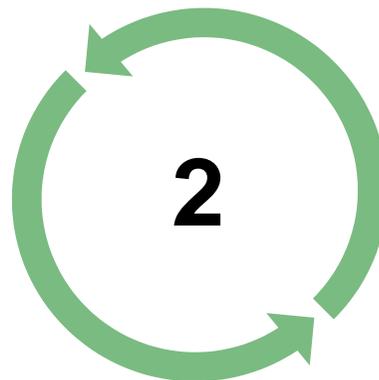
- ESMA has confirmed that the existing date for the application of the equity transparency calculations will remain unchanged and that the transparency calculations that ESMA published on 28 February 2020 would apply to new instruments from 1 April 2020 until 31 March 2021 *(ESMA announcement, 27 March 2020)*

COVID-19 REGULATORY RESPONSE - EU

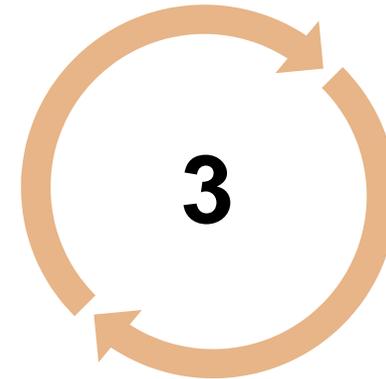
ESMA has deprioritised supervisory actions for non-compliance:



With the revised tick-size regime (introduced in revisions to MiFIR) that took effect on 26 March 2020
Temporary until 26 June 2020 (*ESMA statement, 20 March 2020*)



For interest rate benchmark administrators and contributors to comply with external audit requirements under Benchmark Regulation, where audits are carried out by 30 September 2020 (*ESMA statement, 9 April 2020*)



With the best execution reporting deadlines under MiFID II
Investment firms to publish reports by 30 June 2020, at the latest (RTS deadline was 30 April 2020) (*ESMA statement, 31 March 2020*)

COVID-19 REGULATORY RESPONSE - EU

EBA – reporting delays



- EU firms to be given an additional month to submit supervisory reporting and Pillar 3 disclosures (subject to confirmation of national regulators) – liquidity coverage ratio and resolution planning reporting is excluded from the forbearance (*EBA statement, 31 March 2020*)
- Extension by two months of data remittance by banks for funding plans (from 31 March to 31 May) and QIS exercise (from 8 April to 8 June 2020) (*EBA statement, 25 March 2020*)
- Review of the SVaR observation period could be postponed to the end of 2020 and should not be a supervisory priority (*EBA statement, 22 April 2020*)
- EU-wide stress test postponed to 2021 (*EBA statement, 12 March 2020*)

COVID-19 REGULATORY RESPONSE - EU

PRA – reporting delays



- The PRA will accept a delay of up to one month for the following regulatory reporting requirements where the original remittance dates fall on or before 31 May 2020: COREP Solvency, FINREP, liquidity – stable funding, large exposures and concentration risk, leverage ratio, asset encumbrance, resolution plan reporting (excluding liability structure), supervisory benchmarking exercise – credit risk
- Liquidity coverage ratio, Additional Liquidity Monitoring Metrics and information on firms' liability structure is not included in the forbearance
- A delay of up to one month will be accepted for certain PRA-owned regulatory reporting requirements (e.g., PRA 108 – Memorandum items, FSA 015 – Sectoral information, quarterly returns for Credit Unions and PRA 104-107 – Forecast financial statements), with a two month delay accepted for annual reports and accounts
- The PRA may request more frequent submission of particular reports or additional reporting on key metrics on an ad hoc basis – firms affected by this will be contacted directly by Supervisors
- Pillar 3 disclosure: PRA will be flexible in assessing the reasonableness of any delays to Pillar 3 disclosures
 - Firms should inform supervisors and market participants if they anticipate delays to their Pillar 3 reports and provide reasons for such delays and an estimated publication date where possible (*PRA Statement, “COVID-19 regulatory reporting and disclosure amendments”*)

COVID-19 REGULATORY RESPONSE - EU

FCA – reporting delays



- Firms experiencing difficulties in submitting regulatory data should maintain appropriate records and submit the data as soon as possible
- FCA will accept the following delays to regulatory returns required under the FCA Handbook:
 - SUP 16 – 1 month delay for many returns, with 2 month delay acceptable for FIN-A (annual report and accounts)
 - Firms are not expected to submit Employer' Liability Register compliance return in 2020, but Register should be accurate and up to date
 - Disclosure Guidance and Transparency Rules – 2 month delay for annual financial reports
 - CREDS 9 Annex 1R – 2 month delay for credit union complaints return
 - DISP Annex 1R – 2 month delay for complaints return
 - DISP 1 Annex 1B – 2 month delay for claims management companies complaints return
 - CMC001 – 2 month delay for key data from claims management companies (*FCA website, "Changes to regulatory reporting during COVID-19"*)

COVID-19 RESOURCE CENTER

Visit our COVID-19 Resource Center at <https://www.shearman.com/key-issues/covid-19-resource-center?accordion=regulatory-responses> for the latest global COVID-19 Government and legislative updates and Shearman & Sterling LLP thought leadership

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OVERVIEW



As companies and governments continue to grapple with new challenges resulting from the coronavirus (COVID-19) pandemic, the need for practical legal advice and compliance guidance is more important than ever. Our attorneys are closely monitoring the evolving situation and are committed to providing clients with the latest regulatory updates and legal perspectives.

Please click the headers below to access our library of content, along with our compilation of the latest **COVID-19 Legislation & Government Updates**.

If you have any questions or concerns related to COVID-19, please contact our [COVID-19 Task Force](#). In addition, please do not hesitate to reach out to your relationship partner.

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