Is the European Union going to help us overcome the COVID-19 crisis?

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Introduction

- The global economy has come to a stand-still
- Severe pressure on hospitals and the national health systems worldwide
- Demand for certain services / goods has dried up almost completely:

  - restaurants, hotels, bars, theatres are closed, events have been cancelled
  - aviation companies, travel industry (both leisure & business)
  - oil
  - other non-essential goods / services

Introduction

- **Which in turn triggers defaults under their contracts with their:**

  - employees
  - landlords / real estate owners
  - banks
  - suppliers of goods

- **The downward spiral is also fuelled by reduced tax revenues, creating additional pressure on national governments**

- **Extremely volatile financial markets**

Introduction

- **Unorthodox and far-reaching measures are currently being taken by public authorities worldwide to fight the devastating economic consequences of the COVID-19 virus**

Introduction

- At the international level measures are being taken by, amongst others:

  - World Health Organization (WHO)
  - G-20 / G-7 world leaders
  - International Monetary Fund (IMF)
  - World Bank

- At the level of the European Union

- But mostly at the national level

Programme

- What follows is a discussion of the most striking measures that the European Union has taken or is (possibly) going to take to combat the corona crisis.

- These are roughly the following types of measures:

  (I) a flexible application of European rules that may hinder Member States, which are currently trying to save their national economies;

  (II) a financial support package offered by the EU itself

  (III) monetary action by the ECB and

  (IV) action by European financial supervisors, including the ECB but then as a banking supervisor and not as a monetary authority

Flexible application of EU rules

General escape clause of the EU fiscal framework triggered

- "a severe economic downturn in the euro area or the Union as a whole"
- This offers the flexibility necessary to the national budgets to support the economy and to respond in a coordinated manner to the impact of the COVID-19 pandemic

Temporary State-aid Framework

- To facilitate the swift provision of state-aid to fight the COVID-19 crisis

Guidance on flexibilities offered by EU public procurement rules

- Member States are all busy procuring face masks, protective gloves, and other medical supplies on a large scale in the fight against COVID-19

Financial support package offered by the EU itself

- The above European measures are all aimed at facilitating state aid at national level as much as possible
- In addition, the EU also uses its own resources to combat the crisis (which, of course, are indirectly borne by the Member States)

Coronavirus Response Investment Initiative (CRII & CRII+)

- **CRII:**

  - EUR 37 billion can be used under Cohesion Policy to address the consequences of the corona crisis
  - In addition, the scope of the Solidarity Fund has been broadened to such an extent that it can also be used in public health crises
  -As a result, the most affected Member States have had access to financial support of up to EUR 800 million in 2020 since 1 April

- **CRII+:**

  - On 2 April, the Commission made proposals to make the use of EU funds even more flexible (CRII +), including

  (i) enabling transfers between funds, regions and policy objectives,
  (ii) waiving the obligation to national co-financing, and
  (iii) supporting the most vulnerable in society, for example by providing food packages

Emergency Support Instrument (ESI) & rescEU medical equipment capacity

- The European Commission wants to directly support health care in the Member States

- The Commission intends to mobilize EUR 3 billion from the EU budget for this purpose, of which

  - EUR 2.7 billion will be spent through activation of the Emergency Support Instrument (ESI), and
  - EUR 300 million through the rescEU medical equipment capacity

- The Commission will use the funds for
  (i) central procurement and distribution of medical supplies such as masks and respiratory equipment,
  (ii) transport of medical equipment and patients in cross-border regions,
  (iii) construction of mobile field hospitals

- In the medium and long term, the Commission intends to use the funds to increase corona testing capacity and to fund corona research

Pandemic Crisis Support

- **What are the main ingredients of the support package decided upon by the Eurogroup on 9 April?**

- **<u>First</u>, the conditions under which euro countries can borrow money through the European Stability Mechanism (ESM) have been partially relaxed**

- **Countries that need money can borrow it from the ESM without conditions, as long as it is used for medical care**

Pandemic Crisis Support

- A country that uses the ESM can borrow an amount of 2% of its GDP at the end of 2019
- If all 19 euro countries make use of the ESM, the total amount is EUR 240 billion available for medical care (Pandemic Crisis Support)
- However, the northern countries will probably not rely on this credit line because they do not need it
- And whether the southern euro countries will call on the ESM is very questionable
- Italian Prime Minister Conte's first reaction to his national parliament was that he will not apply for ESM support and he will strive for eurobonds

Pan-European Guarantee Fund

- The <u>second</u> main ingredient of the Eurogroup support package is a pan-European guarantee fund of EUR 25 billion set up by the European Investment Bank (EIB)
- On this basis, a total amount of EUR 200 billion credit can be provided to companies
- This is in addition to the EUR 40 billion already made available by the EIB on 16 March
- On 16 April, the EIB formally approved the deployment of the new guarantee fund
- It is primarily (but not exclusively) intended to support small and medium-sized enterprises (SMEs) in the EU
- The credit granted on the basis of these guarantees is provided, inter alia, through the intermediary of the national banking sector and the national government (national promotional institutions)

Support to mitigate Unemployment Risks in an Emergency (SURE)

- **The <u>third</u> main ingredient of the Eurogroup aid package is a EUR 100 billion short-time and part-time unemployment (SURE) fund**

- **Social security is indeed a national competence, but because the corona crisis is an "extraordinary event" within the meaning of Art. 122 paragraph 2 TFEU, the Union may nevertheless provide financial assistance**

- **On 2 April last, on this legal basis, the Commission proposed a Council regulation "on the establishment of a European instrument for temporary support to mitigate unemployment risks in an emergency (SURE) following the COVID-19 outbreak"**

Support to mitigate Unemployment Risks in an Emergency (SURE)

- **SURE works roughly as follows**
- **Affected Member States can borrow money through this fund on favourable terms**
- **The fund is covered for 25% of the authorized loans by guarantees issued by the Member States, which contribute in proportion to their share of the Union economy**
- **This proposal was also welcomed by the Eurogroup on 9 April, although the final statement emphasizes that it is a temporary measure that should not be seen as the prelude to a European social security system**

Recovery Fund

- The aid package agreed by the Eurogroup on 9 April and confirmed by European heads of government at the special summit on 23 April, thus amounts to a maximum of EUR 540 billion

- But EUR 240 billion that can theoretically be borrowed through the ESM will perhaps not be used

- Then an amount of EUR 300 billion remains

- That may seem like a lot, but it will not be enough.

- The financial situation is becoming increasingly acute for southern euro countries such as Italy, Spain and Greece

- They may not be able to overcome the corona crisis without help

Recovery Fund

- The national debt of these countries was already high and is currently increasing rapidly (although the latter also applies to the northern countries, of course)
- Despite the ECB's PEPP emergency program (see below), the interest rates that these Member States have to pay on their government bonds are also increasing, while tax revenues will (further) fall due to all the economic downturn
- In addition, these countries depend for a significant part of their GDP on tourism and tourists will stay away for the time being
- Not only because they are currently not welcome because of the corona restrictions, but also because of the fear of the corona virus

Recovery Fund

- Moreover, the corona crisis also creates a huge gap in the incomes of the vacationers from the northern member states, so many will stay away for that reason too
- The Eurogroup knows this too, which is why it was included in the final statement of 9 April that a Recovery Fund should be created
- The Eurogroup remains vague about the exact legal design, the relationship with the new European multi-annual budget (2021-2027) and especially the method of financing
- The final statement does contain a reference to financing via "innovative financial instruments“
- According to Dutch Minister of Finance Hoekstra this is in any case not a reference to Eurobonds, but according to his French colleague Le Maire, the only innovative instrument that does not yet exist is joint debt

Eurobonds & Coronabonds

- The Eurobond is a government loan that the eurozone countries issue jointly
- Because highly creditworthy countries such as Germany and the Netherlands participate, interest on such a Eurobond is low, and therefore attractive for southern countries, which have been hit hard by the corona crisis
- Italy now pays about 2 percentage points more interest on the capital market than Germany
- During the eurocrisis, this even rose to 5 percentage points

Eurobonds & Coronabonds

- Northern countries are not enthusiastic about Eurobonds
- Not only would they have to pay a higher interest rate than on their own bonds, they are also exposed to fiscal risks from other countries
- In the unlikely event that one of them is unable to meet its repayment or interest obligations, the others will suffer
- After all, they have to pay the money to correctly repay Eurobond investors
- Coronabonds are a specific form of Eurobonds because they are limited in time, size and spending
- Southern countries could only use the proceeds from the issuance of coronabonds to finance measures to mitigate the economic damage caused by the crisis

Eurobonds & Coronabonds

- Think of financial assistance to companies
- So they cannot spend the money raised to pay off past loans
- In the evening of 9 April 2020 the European Ministers of Finance rejected the issuance of Eurobonds/Coronabonds -> the Netherlands, Germany, the Baltic States, Finland and Austria were not prepared to agree to it (unanimity required)
- Does this mean that Eurobonds / coronabonds are off the table? Not quite!

Recovery Fund – latest developments

- In the run-up to the subsequent summit of European government leaders on April 23, European Commissioner Dombrovskis announced via the German business newspaper Handelsblatt that the European Commission is thinking of a Recovery Fund of 1,500 billion euros

- This short-term fund would then have to raise money on the capital markets via bonds guaranteed by the euro countries

- The money collected can then lend the funds on favourable terms to those Member States that need it to restore their economies

- France, amongst others, agrees to this approach

Recovery Fund – latest developments

- In a non-paper published shortly before the summit, Spain put forward the idea that the Recovery Fund should not provide loans, but rather subsidies to Member States in need, because otherwise the national debts of these countries would increase too much
- According to Spain, the fund should be financed through the issue of perpetual eurobonds, that is to say through bonds that never have to be redeemed and on which only interest is payable
- Investing in these types of bonds is therefore somewhat similar to investing in shares

Recovery Fund – latest developments

- Heads of government announced after the summit that (i) they are working on a Recovery Fund, (ii) they see the urgency of it, (iii) the fund must be of sufficient size, (iv) it must be focused on aid to the sectors and regions most in need of aid and that (v) the Commission must now come up with concrete proposals

- At the press conference after the summit, Commission President Van der Leyen immediately announced that she wants to raise at least EUR 1,000 billion in loans though the capital markets, with the Member States being required to guarantee the loans

- It is still unclear in what form these amounts must be channeled to the Member States in need (loans, subsidies, something in between)

- The Commission will come up with concrete plans in May and it will then become clear whether it has come up with an approach that could lead to the approval of the northern and southern Member States

- TO BE CONTINUED….

Action taken by ECB as monetary authority

- **The ECB managed to keep the euro afloat in 2012 by expressing its readiness to massively buy euro area government bonds through the secondary markets**
- **The famous "whatever it takes" speech by then-ECB President Draghi**
- **The ECB actually started buying eurozone government bonds in 2015**
- **Since the ECB started its purchase programmes, it never stopped buying government debt issued by the eurozone countries**
- **The CJEU has confirmed the such purchase programmes are legal, provided their primary purpose is to maintain price stability (see CJEU 16 June 2015, C-62/14 (*Gauweiler*) and subsequent cases)**
- **In any event, on 24 March 2020 the ECB decided to accelerate further to keep the massive corona support of the Member States affordable**
- **Moreover, since the ECB buys government bonds on the secondary market from the banks, space is created on national bank balance sheets to provide new loans to business and households**

Action taken by ECB as monetary authority

- As mentioned, significant doubts remain as to the effectiveness of this type of buying program
- Although this will create space on bank balance sheets, hopefully banks will only lend to essentially creditworthy companies and households, also because they otherwise risk a breach of their duty of care due to reckless lending
- Although this may well be different if loans are backed by government guarantees for the full amount
- And the creditworthiness of many euro area businesses and households has been badly affected by the corona crisis, despite all the financial support provided by Member States and the Union
- At least, according to the IMF, a worldwide credit crunch is realistic if the corona virus does not gradually disappear as assumed in its mild scenario in the second half of this year

Action taken by ECB as monetary authority

- Be that as it may, the ECB's additional buying program is the so-called Pandemic Emergency Purchasing Program (PEPP)
- The size of PEPP currently amounts to a maximum of EUR 750 billion and can be deployed until the end of 2020 for the time being
- Importantly, the ECB has abandoned certain self-imposed restrictions in the PEPP program, which did apply to previous programs, such as with regard to the still operational Asset Purchase Program (APP)
- For example, the purchase of government bonds no longer has to be strictly neutral, that is to say more or less in proportion to the size of the various eurozone economies
- So in theory the ECB could now massively buy Italian, Greek and Spanish government bonds because the need is greatest there

Action taken by ECB as monetary authority

- But PEPP is also no miracle cure,
- not only because banks will hopefully only lend money to essentially creditworthy parties (see above),
- but also because the interest rate that Member States such as Italy have to pay on their government bonds increases further despite PEPP

Discussion

- **Is it a good development that the ECB can now massively buy Italian, Greek and Spanish government bonds?**

Action taken by EU financial supervisors

- European financial supervisors are also busy and are trying to fight the corona crisis
- With European financial supervisors, I am primarily referring to the ECB in its capacity as prudential (prudential) supervisor of the major banks in the eurozone,
- and also to the European Banking Authority (EBA),
- the European Securities and Markets Authority (ESMA) and
- the European Insurance and Occupational Pensions Authority (EIOPA)
- I would like to point out here that EBA, ESMA and EIOPA do not, if at all, provide concrete supervision of financial institutions, but mainly assist in the creation of European financial supervision law and, in addition, usually provide formal non-binding, but authoritative explanations
- I will limit myself here to some notable measures that have been taken so far

Capital requirements, NPLs and IFRS9

- On March 12, the ECB announced in a press release that banks may temporarily maintain lower capital buffers
- The EBA announced on the same day that the ECB and national banking supervisors in the EU should be flexible in applying the capital requirements
- Not much later, the ECB announced further flexibility, such as
- favourable prudential treatment of non-performing loans (NPLs) if they are covered by government guarantees and
- flexible application of international IFRS9 accounting rules
- EBA and ESMA advise in the same line a few days later

Capital requirements, NPLs and IFRS9

- All these measures would in theory allow banks to extend more credit to businesses and households than would normally be the case
- But also here applies: hopefully banks will only lend to the core creditworthy parties, although this may be different if loans are fully backed by government guarantees
- Moreover, the bank balance sheets must continue to give a true and fair view of the financial situation
- In a letter dated 1 April last, the ECB asked the significant eurozone banks to take into account a possible recovery of the economy in 2020 when applying the international accounting rules

Capital requirements, NPLs and IFRS9

- Financial reporting specialists warn that this type of guidance from supervisors is extremely dangerous because IFRS9 requires banks to predict their own financial health, and that of the money lent, on the basis of independent macroeconomic measures such as GDP, or unemployment figures

- Be that as it may, the various measures of the European financial supervisors were confirmed on April 28 and further elaborated in an "Interpretative Communication" issued by the European Commission

- On the same day, the Commission proposed legislation to relax European banking rules in connection with the corona crisis

Discussion

- **Is it a good thing that banks may temporarily maintain lower capital buffers?**
- **Should European bank supervisors indeed be flexible in applying the capital requirements?**
- **Is a favourable prudential treatment of non-performing loans (NPLs) if they are covered by government guarantees a good thing?**
- **Is a flexible application of international IFRS9 accounting rules a good thing?**

Dividend payments, share buybacks and bonuses

- In addition, the ECB, EBA and the Commission are urging banks to suspend dividend payments, share buybacks and bonus payments
- Here again, the idea is that capital will be released to support the real economy in these difficult times
- The sector appears to be responding to this call

Postponement of various supervisory deadlines

- Anyone who works in the financial sector knows how much time and effort it takes to comply correctly with the increasingly complex web of (mostly European) financial supervision law
- For example, there is a long laundry list of reporting obligations that financial institutions must comply with, not only towards national and European supervisors, but also towards the financial markets
- Pressure on workers has also increased in the financial sector
- The still healthy employees have to do more work due to the loss of sick colleagues, while their productivity decreases due to all restrictive corona measures such as working from home with children playing in the background
- Furthermore, the corona crisis also generates a lot of extra work
- European financial supervisors have therefore postponed numerous supervisory deadlines to relieve pressure in the financial sector where possible, so that the sector can focus on its core activities

Ban on short-selling

- In times of crisis, the financial markets are volatile and certain investors typically speculate on a fall in stock prices through short selling
- This is also the case now
- If investors go 'short' on a large scale, stock prices may fall extra sharply
- European financial market supervisor ESMA can prohibit shortselling Europe-wide if exceptional market conditions exist
- National supervisors can prohibit short selling in their own Member State for the same reason
- The competent supervisors in Spain, Italy, France, Belgium, Greece and Austria have already done so
- As yet, ESMA sees no reason to ban shortselling across Europe
- However, it has lowered the threshold for reporting net short positions to supervisors to ensure that developments can be monitored even more accurately than usual

Thanks for you attention!

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