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Chair Andrea Enria
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**The possible lifting of restrictions on distributions of supervised institutions and the ECB's legal powers in this regard**

Dear Chair, dear Andrea,

We are writing to you ahead of the ECB's upcoming decision whether to extend beyond 31 December 2020 its recommendation to supervised entities not to distribute dividends or buy back shares[1]. Recent statements by several members of the Governing Council suggest that the recommendation might be discontinued, or only upheld on a case-by-case basis. Such an approach seems to be at odds with your repeated and vehement warnings that the worst might be yet to come for euro area banks in the current crisis. This made us wonder whether you consider the ECB has the adequate toolkit at its disposal to tackle the pandemic in the most prudent and effective manner.

**The worst is yet to come**

The ECB and other institutions have recently expressed their strong concern that the real impact of the pandemic on the European banking system might only materialise in the coming months or years. You as chairman of the Supervisory Board have repeatedly stressed that, under a particularly severe scenario, non-performing loans of euro area banks could grow to 1.4 trillion euros[2]. Christine Lagarde, in her capacity as chairwoman of the ESRB, warned in her last hearing before the ECON Committee that "vulnerabilities will take time to manifest themselves on bank balance sheets—not least on account of the widespread use of debt service moratoria" and that "ultimately, the deteriorating quality of bank assets and the concomitant rise in provisions will take a toll on banks' profitability and capital positions"[3]. This is underpinned by the EBA's recent thematic note on the use of moratoria and public guarantees in the EU banking sector[4]. The report finds that in half of the member states, more than 10% of all loans to non-banks had been granted moratoria as of 30 June 2020.

[1] On 27 March, the ECB had asked banks to refrain from any dividend distributions and share buy-backs during the pandemic. After an extension on 28 July, your current recommendation will expire on 1 January 2021.
[2] https://www.bankingsupervision.europa.eu/press/interviews/date/2020/html/ssm.in201027~31fda4bb8e.en.html
[3] https://www.esrb.europa.eu/news/speeches/date/2020/html/esrb.sp201119~c102f4eb27.en.html
[4] https://eba.europa.eu/banks-report-significant-use-covid-19-moratoria-and-public-guarantees

## Flying blind

Against this background, it is worrying that the numbers published by European banks do not reflect the real impact of the pandemic reliably. Apart from moratoria and public loan guarantees, this is in particular due to communication by the ECB from March which invited banks to take a cautious approach towards loan loss provisions under IFRS 9[5]. As a result, current loss provisions likely are not a truthful representation of banks' expected credit losses. According to press coverage, you have made this point yourself at a recent conference, referring to the current situation as "flying blind"[6]. Likewise, Vice-President Luis de Guindos recently warned that banks' provisions "look optimistic in some cases, while guarantees and moratoria may have lengthened the time it takes for weak economic performance to translate into loan losses"[7]. This is supported by findings in the November edition of your Financial Stability Review[8]. The report finds that provisions by euro area banks have been substantially lower than those of their US peers and ECB model projections, and that banks with low profits have been particularly reluctant to write down debt. While these effects could partially be explained by other factors, the report suggests that they might be indicative of inadequate loss provisioning. Also a recent blog post by Supervisory Board member Elizabeth McCaul documents the differing and partly inadequate approaches to provisioning by euro area banks[9].

We appreciate that the ECB is now taking efforts to restore transparency and calls on banks to more truthfully identify their risks and losses, as expressed in your recent 'Dear CEO' letter[10]. In particular, it is most welcome that the ECB has partially revised its recommendation with respect to IFRS 9 and now requires banks to perform more adequate loan loss provisioning. In our view, supervisors should under all circumstances refrain from encouraging institutions to apply creative accounting as this reduces transparency and comparability, which is particularly harmful during crises. As long as the restoration process has not been completed, the view on the real risks in the euro area banking sector remains blurred.

## To ban or not to ban

Taken together, these observations imply that a new banking crisis, maybe as early as 2021, clearly is a possible scenario. But despite the enormous uncertainty about the health of the European banking sector going forward, several members of the Governing Council such as Fabio Panetta or François Villeroy de Galhau have recently shown support for discontinuing the blanket recommendation not to distribute dividends and buy back shares after January 2021, and replacing it by a case-by-case assessment[11].

In contrast, several members of the Supervisory Board have voiced scepticism towards lifting the de facto ban on distributions. Yves Mersch in a recent interview argued that "it would be a little bit spurious or surprising if the banks were to use the public subsidies to enrich the shareholders" and that as long banks "are asking for continued support I think we should be very conservative with the pure resumption of payout ratios that we have seen before the crisis"[12]. In a similar vein, Ed Sibley recently spoke in favour of extending

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[5] https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200320~4cdbbcf466.en.html
[6] https://www.politico.eu/article/banks-near-day-of-reckoning-on-bad-loans-coronavirus/
[7] https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr201125~01dfca322a.en.html
[8] https://www.ecb.europa.eu/pub/financial-stability/fsr/html/ecb.fsr202011~b7be9ae1f1.en.html#toc19
[9] https://www.bankingsupervision.europa.eu/press/blog/2020/html/ssm.blog201204~c49fb771c6.en.html
[10] https://www.bankingsupervision.europa.eu/press/letterstobanks/shared/pdf/2020/ssm.2020_letter_credit_risk_identification_measurement~734f2a0b84.en.pdf?c839e6212e8a9bf18dc0d26ab0b1cd7f
[11] https://www.bloomberg.com/news/articles/2020-11-27/ecb-signals-bank-dividend-ban-could-be-cautiously-lifted-in-2021
[12] https://www.bankingsupervision.europa.eu/press/interviews/date/2020/html/ssm.in201125~744661954a.en.html

the recommendation by another six months[13]. Both, however, pointed out that the ECB would likely face practical or legal hurdles, indicating that the ECB might discontinue its recommendation simply because it lacks the legal powers to uphold it.

**Making the ECB toolkit fit for crises**

The comments of your colleagues suggest to us that your toolkit is lacking certain instruments related to the restriction of distributions of supervised entities. Clearly, it would be highly unsatisfactory and potentially dangerous if the ECB was to take decisions it considers imprudent for the sheer lack of adequate supervisory powers. As European lawmakers, we would therefore like to understand if you would consider it beneficial or even indispensable for the proper fulfilment of your mandate that you were granted additional powers regarding the restriction of distributions. In particular, we would be very interested to hear whether you would consider blanket and legally binding dividend and buy-back bans a helpful supervisory tool during times of crisis.

We look forward to your clarifications and your views on this issue.

Yours sincerely,

Sven Giegold & Ernest Urtasun
MEPs for Greens/EFA

[13] https://www.bloomberg.com/news/articles/2020-12-04/ecb-urged-to-extend-bank-dividend-ban-six-months-by-top-watchdog