Commission de Surveillance du Secteur Financier

Circular letter CSSF

CSSF recommendation on restriction of distributions during the COVID-19 pandemic

Circular letter CSSF

Re: CSSF recommendation on restriction of distributions during the COVID-19 pandemic

Luxembourg, 29 July 2020

To all credit institutions (that are not Significant Institutions under the SSM)

Ladies and Gentlemen,

On April 1 2020, the CSSF announced its intention to comply with the ECB "Recommendation on dividend distributions during the COVID-19 pandemic" (ECB/2020/19) issued on 27 March 2020[1] and its endorsement of the EBA "Statement on dividends distribution, share buybacks and variable remuneration" dated 31 March 2020 (hereinafter the "EBA Statement")[2].

This circular letter is triggered by two new European initiatives on the topic of restrictions of distributions. On 27 May 2020 the European Systemic Risk Board (ESRB) published a Recommendation on restriction of distributions during the COVID-19 pandemic (ESRB/2020/7) which is also related to and has implications for credit institutions (hereinafter the "ESRB Recommendation")[3]. Following up with the ESRB Recommendation, on 27 July 2020, the ECB published Recommendation (ECB/2020/35) on dividend distributions during the COVID-19 pandemic (hereinafter the "ECB Recommendation")[4] which repeals Recommendation ECB/2020/19, extending until at least 1 January 2021 the restriction to pay out dividends or to make irrevocable commitments to pay out dividends, and refraining from share buy-backs aimed at remunerating shareholders. The ECB Recommendation advises national competent authorities to apply the same principles for LSIs. The CSSF also remains committed to the aim of ensuring a globally coordinated response to the COVID-19 pandemic under the umbrella of the Basel Committee on Banking Supervision and the Financial Stability Board.

In this context, this circular letter provides an update of the CSSF policy on restrictions of dividend distributions and share buybacks, considering all the above European texts, and provides guidance as well on the CSSF's expectations with regard to remuneration practices.

[1] Link to the ECB Recommendation 2020/19

[2] Link to the EBA Statement

[3] Link to the ESRB Recommendation

[4] Link to the ECB Recommendation 2020/35

The COVID-19 FAQ 13 has also been updated in accordance to this Circular letter.

The CSSF intends to comply with the ECB Recommendation, the EBA Statement and the ESRB Recommendation and recommends that Luxembourg credit institutions apply the principles described in the paragraphs below.[5]

a) Dividends distribution and share buy-backs

The management bodies of Luxembourg credit institutions shall refrain from taking decisions on distributions that would constrain their bank's capacity to meet the COVID-19 induced needs for liquidity and credit of the customers in the markets they serve and/or they would have the effect of reducing the quantity or quality of the bank's own funds or reducing their loss absorbing capacity for the duration of the COVID-19 related crisis.

Such decisions include amongst others paying out or irrevocably committing to pay out dividends for the financial years 2019 and 2020 or buying-back shares. The term 'dividend' as used here refers to any type of cash pay-out in connection with Common Equity Tier 1 capital which has the effect of reducing the quantity or quality of own funds and does not include stock dividends.[6] Banks that have already submitted dividend distribution proposals for their upcoming general shareholders' meeting are expected to amend such proposals in line with the ECB Recommendation and the ESRB Recommendation. In line with the ECB Recommendation and the ESRB Recommendation, the CSSF does not require that dividends already paid out for the financial year 2019 be retroactively invalidated.

[5] *For the significant supervised entities and significant supervised groups, the approach of the Single Supervisory Mechanism (SSM) applies.*

[6] *Dividend distributions solely in the form of ordinary shares are allowed provided they do not reduce the quantity or quality of own funds. Such dividend distributions should nevertheless be designed in such a way that they do not mechanically increase dividends to be paid out in subsequent years, in particular for banks expressing their dividend policy in a fix amount per share.*

In its Statement, the EBA “considers that ensuring the efficient and prudent allocation of capital within banking groups is crucial”. “Capital distributions within a banking group should serve the need to support the local and the broader European economies as well as to ensure the proper functioning of the Single Market.” This statement holds equally true at the level of the global financial system.

While this Circular letter is primarily addressed to banks at the highest level of consolidation, the CSSF expects that the management bodies of Luxembourg banking subsidiaries engage with their shareholders and subsidiaries so as to ensure that their dividend policy is compatible with the broad objectives framed in the preceding paragraphs.

Banks that encounter difficulties to comply with the above should without delay explain the underlying reasons to the CSSF.

Luxembourg credit institutions that intend to pay out dividends or undertake an irrevocable commitment to pay out dividends to their parent which is established outside the euro-zone (SSM area) should contact the CSSF to determine whether such pay-outs would be appropriate.

b) Variable remuneration

The CSSF continues to pay close attention to the remuneration policies of the credit institutions under its supervision, and in particular to any impact that such policies may have on the maintenance of a sound capital base in view of ensuring that credit institutions maintain a sufficiently large amount of capital to absorb potential losses and to support the real economy by providing credits to households, small businesses and corporates.

In line with the aforementioned EBA Statement and the ESRB Recommendation and taking into account aforementioned considerations, the CSSF expects credit institutions to adopt extreme moderation with regards to variable remuneration payments until 1 January 2021, especially those to material risk takers.

In that respect, credit institutions shall adopt prudent variable remuneration decisions and in doing so shall refrain from taking decisions that would create an obligation to pay variable remuneration to material risk takers, which would constrain their capacity to meet the COVID-19 induced needs for liquidity and credit of the customers in the markets they serve and/or they would have the effect of reducing the quantity or quality of their own funds or reducing their loss absorbing capacity for the duration of the COVID-19 related crisis.

In doing so, the CSSF expects credit institutions to reduce, to the extent possible, the payment of variable remuneration, which in any case should not expose the institution to litigation or legal risk, and to consider paying variable remuneration in instruments and this especially for material risk takers.

The decisions referred to above include amongst others paying or committing to pay out variable remuneration for the performance years 2019 and 2020. However, the CSSF does not require credit institutions to retroactively invalidate any decision on variable remuneration already taken and validated by their management body.

The terms ‘variable remuneration’, ‘instruments’ and ‘material risk takers’ are to be understood and used here as defined in the law of 5 April 1993 on the financial sector, in the Commission Delegated Regulation (EU) n° 604/2014 and in the EBA guidelines on sound remuneration policies (EBA/GL/2015/22).

Finally, the CSSF particularly underlines that the reputational impact of the payment of variable remuneration in a global crisis situation should not be underestimated – particularly in the case of large individual amounts – and should be duly considered, also bearing in mind the important role of credit institutions in tackling the crisis.

The CSSF recommendations under points a) and b) above apply until 1 January 2021.

Given the temporary nature of these measures, the CSSF will further evaluate the economic situation and, together with other relevant authorities, consider whether this deadline should be extended after 1 January 2021.

Yours faithfully,

Christiane Campill Premier Conseiller de Direction	**Claude WAMPACH** Director

Commission de Surveillance du Secteur Financier
283, route d'Arlon
L-2991 Luxembourg (+352) 26 25 1-1
direction@cssf.lu
www.cssf.lu