



Pillar 2 Guidance (P2G): Banking regulations: what has changed?

The Covid-19 crisis has disrupted European banking supervision rules. The temporary reduction of certain capital requirements, approved in March 2020, will be extended to next year as planned. **The P2G buffer (Pillar 2 Guidance) will not need to be reconstituted before the end of 2022.** The method of calculating P2G will also evolve, as announced this summer by Andrea Enria, President of the Single Supervisory Mechanism (SSM).

A few reminders about bank capital requirements

Banking institutions' capital is broken down into several layers that complement each other:

- The **Pillar 1 and Pillar 2 R ("P2R")** requirements are legally binding on banks, as is the **Combined Buffer Requirement ("CBR")**.
- The **Pillar 2 Guidance (P2G)** has the distinctive feature of being legally non-binding. However, it enters into the calculation of total capital requested from banks and makes it possible to define the distribution capacity to

shareholders (dividends, share buybacks). As a result, each institution takes this recommendation into account. P2G is designed to protect financial institutions in the event of an economic or financial crisis.

- Banks report on a capital ratio that includes all of these layers of capital, excluding P2G, to which an additional margin of safety is generally added in order to remain above the required level applied to them. This management buffer implicitly includes P2G requirements.



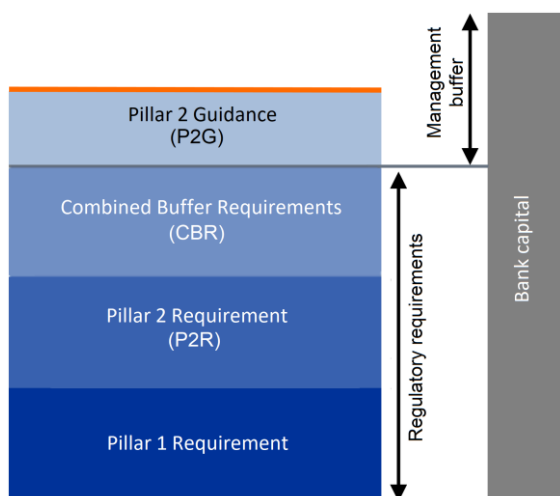
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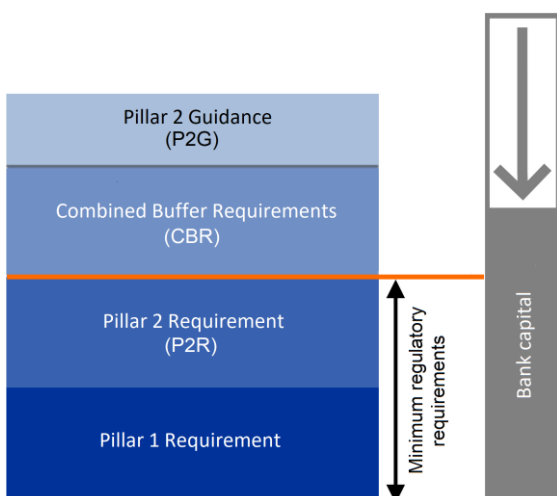
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In times of stress, **the ECB authorises banks not to apply the P2G buffer. The CBR can also be temporarily lifted** in exchange for certain limitations on the payment of dividends, bonuses or coupons on AT1* securities. The situation then corresponds to the following graph:



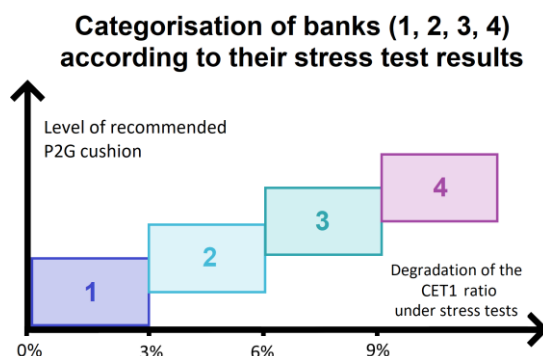
New announcements regarding the “P2G”

Following the outbreak of the Covid-19 crisis in March 2020, the ECB activated this system of easing capital requirements. European banks have therefore no longer been subject to compliance with the P2G buffer since that date. Until this summer, however,

there was uncertainty around the timetable for its reintroduction. On 7 July, the President of the Single Supervisory Mechanism (SSM), Andrea Enria, clarified the situation with two new announcements:

- The Pillar 2 Guidance buffer (P2G) will not need to be reconstituted before the end of 2022.
- **The P2G calculation methodology will now be adapted to take into account the results of the stress tests published on 30 July 2021.**

Based on this new methodology for calculating P2G, **European banks will now be classified into four categories.** The greater the impact on banks during the last stress tests (the theoretical reduction of their capital in the event of an economic and financial crisis), the higher the P2G buffer they will have to build.



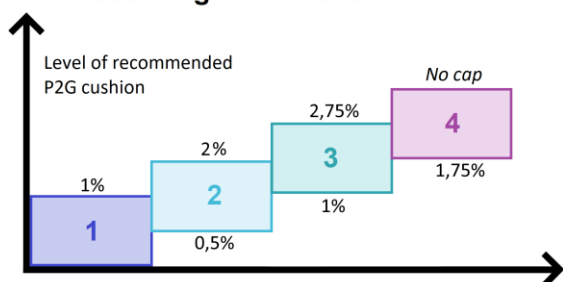
Today, the average P2G established by banks represents a wide range between 1.0% and 1.9% of CET1*. This level is closer to 1.0% for systemic banks (G-SIBs), 1.4% for small domestic or commercial banks, and 1.8% for specialized banks or banks focused on professional clients (corporate).

Going forward, **the minimum 1% threshold should be removed.** The ECB has communicated on the ranges of P2G ratios according to the four categories, as presented below:

* AT1: Additional Tier 1

* CET1: Common Equity Tier 1

Estimated P2G recommendations according to banks' classification



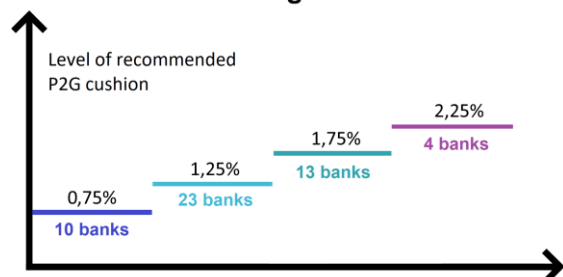
However, the calibration of P2G will not be carried out completely mechanically, but will be assessed by the teams in charge of supervision ("Joint Supervision Teams" or JSTs).

We believe that on average, banks will have to build a P2G buffer as follows:

- 0.75% only for banks with the most solid stress test results (category 1),
- 1.25% for banks in category 2,
- 1.75% for category 3,
- 2.25% for the last banks in category 4.

The 2021 Stress Test was carried out on 50 of the largest banks in the European Union. The number of banks classified in each category, as well as the estimate of the P2G buffer to be established for these institutions, is detailed in the diagram below:

Lazard Frères Gestion's estimated future average P2G levels



Good news for banks and investors

These recent announcements provide better visibility for the banking sector. The P2G was previously a relatively opaque prudential buffer, both in its calibration by the ECB and in its communication to investors. Banks' practices in this area could vary, at the risk of being uneven.

The modification of the P2G calculation rules will now provide greater homogeneity between two banks with identical profiles. The four categories will also serve as benchmarks to define the efforts that need to be made to ensure that an institution can progress from one category to another. Clear targets can therefore be established with regard to the NPL ratio, the level of profitability, the capital ratios and the liquidity ratio to be achieved. These criteria will also serve as benchmarks for investors.

With regard to the implementation schedule, it is now assumed that the reintroduction of P2G will not take place before the beginning of 2023. This deadline will allow banks to rebuild their buffer very gradually, which is good news for the banks most affected by the Covid-19 crisis. Thanks to this flexibility, banks will also be able to continue to raise more capital next year to finance the economy and its recovery.

It should be noted that in terms of bank debt securities (senior debt, Tier 2 subordinated debt, and AT1), the measure has no immediate effect as it changes neither the level of risk nor, of course, the credit rating of the institutions concerned. On the other hand, greater transparency will enable investors to carry out certain arbitrage operations in the future by benefitting from more extensive details regarding each institution's capital structure.

List of 50 banks that participated in the EBA's latest stress test, reduction of the CET1 ratio in the adverse scenario over three years and classification by category:

Country Name	Bank Name	Delta in Adverse Scenario	Category	P2G Range	LFG Avg Estimates
Sweden	Länsförsäkringar Bank AB (publ)	-80	1	0%-1,00%	0,75%
Spain	Bankinter, S.A.	-104			
Sweden	SBAB Bank AB – group	-108			
Poland	Powszechna Kasa Oszczednosci Bank Polski SA	-162			
Poland	Bank Polska Kasa Opieki SA	-165			
Sweden	Swedbank — group	-214			
Spain	Banco Santander S.A.	-240			
Norway	DNB Bank Group	-252			
Germany	Volkswagen Bank	-262			
Portugal	Caixa Geral de Depósitos, SA	-288			
Belgium	Belfius Banque SA	-309	2	0,50%-2,00%	1,25%
Spain	Banco Bilbao Vizcaya Argentaria S.A.	-319			
Sweden	Skandinaviska Enskilda Banken — group	-357			
Finland	Nordea Bank Abp	-369			
Belgium	KBC Group NV	-381			
Portugal	Banco Comercial Português, SA	-389			
Austria	Erste Group Bank AG	-410			
Sweden	Svenska Handelsbanken — group	-410			
Hungary	OTP Bank Nyrt.	-415			
Netherlands	ABN AMRO Bank N.V.	-418			
Netherlands	ING Groep N.V.	-445	3	1,00%-2,75%	1,75%
France	BNP Paribas	-448			
Austria	Raiffeisen Bank International AG	-462			
Italy	Mediobanca - Banca di Credito Finanziario S.p.A.	-467			
Germany	COMMERZBANK Aktiengesellschaft	-470			
Germany	DZ BANK AG Deutsche Zentral-Genossenschaftsbank	-499			
France	Confédération Nationale du Crédit Mutuel	-530			
Italy	Intesa Sanpaolo S.p.A.	-533			
Spain	Banco de Sabadell S.A.	-550			
Germany	Landesbank Hessen-Thüringen Girozentrale	-561			
France	Société générale S.A.	-570	4	1,75%-4,50%	2,25%
France	Groupe BPCE	-580			
Germany	Bayerische Landesbank	-590			
Germany	Deutsche Bank AG	-609			
Ireland	Bank of Ireland Group plc	-611			
Finland	OP Osuuskunta	-619			
France	Groupe Crédit Agricole	-631			
Denmark	Nykredit Realkredit	-631			
Denmark	Jyske Bank	-634			
Italy	UniCredit S.p.A.	-637			
Germany	Landesbank Baden-Württemberg	-662	4	1,75%-4,50%	2,25%
France	HSBC Continental Europe	-667			
Netherlands	Coöperatieve Rabobank U.A.	-669			
Denmark	Danske Bank	-679			
Netherlands	Nederlandse Waterschapsbank N.V.	-728			
Italy	Banco BPM S.p.A.	-758			
France	La Banque Postale	-916			
Ireland	AIB Group plc	-936			
Netherlands	BNG Bank N.V.	-989			
Italy	Banca Monte dei Paschi di Siena S.p.A.	-1 179			
Average		-498			1,50%

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