

QUESTIONS & ANSWERS

Process

1. Why has the EBA undertaken a recapitalisation exercise?

The EBA recapitalisation exercise was designed and performed with the primary aim of strengthening banks' capital positions to shore up market confidence in the EU banking sector, against the backdrop of a difficult macroeconomic environment and the aggravation of the sovereign debt crisis in Europe. This exercise is one of a series of coordinated policy measures agreed by the European Council last October. The EU package called for additional capital as a necessary measure to reassure investors about banks' ability to withstand any further shocks and to remain well protected against residual credit risk.

2. Why can't we refer to this exercise as a "stress test"?

The capital exercise is not a stress test. It takes actual, not stressed, figures and is just a requirement to establish a buffer of high quality capital above minimum regulatory requirements. A stress test is aimed at simulating the impact of adverse macroeconomic and financial market developments on the banks' capital positions over a certain time horizon. Unlike stress tests, the capital exercise did not apply any adverse macro-economic scenarios nor requested the banks to produce estimates of their losses under such circumstances. Banks have been asked to set up a buffer of capital so that their Core Tier 1 ratio was above the 9% threshold, after establishing a buffer related to prudent valuation of their sovereign debt holdings so as to reassure that they have a much improved capacity to absorb losses.

3. Has the recapitalisation exercise achieved its goals?

During the second half of last year, the global markets were extremely concerned about EU banks' levels of capital and their ability to withstand further shock. This was addressed by the EBA recapitalisation exercise. Overall, the EBA exercise has led to a significant strengthening of banks' capital positions of more than €200 bn. Overall, the average CT1 of the 61 banks, for which the EBA publishes individual data, reached 10.7% in June 2012, after accounting for the sovereign buffer. However it is important to highlight that the recapitalisation exercise in and of itself is not the last step towards repairing EU banks' balance sheets and restoring market confidence. Banks' compliance with the EBA's Recommendation will be closely monitored by National Supervisors in cooperation with the EBA and within the colleges of supervisors in view of the transition to CRDIV.

4. How can you compare the results of the Basel III monitoring exercise to the final outcome of the recapitalisation exercise?

The results stemming from the recapitalisation exercise cannot be compared to the findings of the Basel III monitoring exercise for the following reasons:

- 1) the sample of banks involved in the two exercises is different;
- 2) the reference dates differ: Basel III monitoring results are based on data as of 31 December 2011 while the final recapitalisation report is based on banks' data as of June 2012;
- 3) the definition of capital used is different: for the Basel III monitoring exercise the capital definition is the one adopted by the Basel Committee in December 2010 while for the EU recapitalisation exercise it is the one used in the 2011 EU-wide stress test which is based on existing CRD definition of Tier 1 net of deductions of participations in financial institutions and it strips out hybrid instruments including existing preference shares.
- 4) the capital exercise was designed as a one-off measure to address the difficult situation in the EU banking system, especially with regard to the sovereign exposures, while the Basel III monitoring exercise is a regular exercise aimed at providing an impact assessment on a number of key aspects, assuming full implementation of Basel III;

5. Isn't the recapitalisation exercise leading banks to being more reluctant to lend?

It has sometimes been argued that a regulatory requirement to increase capital in the current situation would impact negatively lending growth thus hurting the economy. However, as we have observed both during the current crisis and in previous ones (for example during the European banking crisis 20 years ago), banks with border-line capital levels – or perceived by the market as being so – are those that have been most reluctant to increase lending and were viewed negatively by the market, with consequences for their funding and equity valuations. Banks with large capital positions, by contrast, are less sensitive to cyclical shocks and are thus more likely to pursue lending-growth strategies even in more difficult markets. Without additional capital buffers, problems in accessing funding are likely to create severe deleveraging pressures, forcing weakly capitalised banks to cut credit to the real economy.

6. What distinct roles did the EBA and the competent national authorities play in reviewing implementing and monitoring banks' capital plans in the recapitalisation exercise?

The recapitalisation exercise was launched and coordinated by the EBA in close cooperation with the competent national authorities and with the support of the European Institutions. In particular, the EBA put forward a Recommendation to competent national authorities to request banks to set aside exceptional and temporary capital buffers to address current market concerns over sovereign risk. The national competent authorities committed to complying with the EBA Recommendation and to enforcing the new requirements using their respective supervisory powers. To this end, they were responsible for carrying out an in-depth analysis of the banks' capital plans and for ensuring that they were in line with the Recommendation. This included in particular an assessment of the measures aimed at reducing risk weighted assets (RWAs), to ensure a strict scrutiny of the capital alleviation

deriving from the validation and roll over of appropriate internal models as well as the compliance of deleveraging measures with the criteria defined by the EBA Recommendation and designed to avoid adverse impacts on lending to the real economy. All relevant competent authorities and the EBA discussed banks' plans within colleges of supervisors which provided the opportunity to consider the plans more in depth and to understand the viability of the proposed measures and the implications for the markets in the various countries. The national competent authorities bore ultimate responsibility for the approval of banks' capital plans. Going forward, consolidating supervisors, in conjunction with the EBA and within the colleges of Supervisors, will be monitoring banks' capital plans to ensure their level of capital is maintained in 2013 and beyond. Within the framework of the capital exercise, no assessment of assets quality was undertaken by the EBA as this was beyond the scope of the exercise, and remains the responsibility of national authorities.

Outcome

7. What is the breakdown of the bank capital strengthening of €200bn?

Overall, the EBA exercise has led to a significant strengthening of banks' capital positions of more than €200 bn. For the 27 banks with an initial shortfall and for which plans were requested, the exercise resulted in an aggregate recapitalisation amount of €115.7bn. For the 34 banks involved in the exercise but that did not show any initial shortfall, the exercise led to a capital strengthening of €47bn. In addition, 4 banks have undergone a significant restructuring. Among those, one the Spanish banks in the sample, Bankia, will receive an injection of €24bn of capital in the framework of the EFSF financial assistance for the recapitalisation of financial institutions programme. Finally, a capital amount of €18bn has, so far, been injected in the Greek banks in the framework of the EU/IMF financial assistance programme.

8. Has the EBA Recommendation allowed banks to reach the set target by “tweaking” their RWAs calculations, thus achieving the so called “risk-weighted asset optimization”?

As clearly stated in the EBA Recommendation, reductions in risk weighted assets (RWAs) due to the validation, roll-out and changes of appropriate internal models are not allowed as a means of addressing the capital shortfall unless those changes had already been planned and under consideration by the competent authority. According to the figures published today, those actions accounts for 9% of the total recapitalisation amount for the 27 banks with an initial shortfall.

9. Has the EBA Recommendation resulted in fire sales of bank assets?

The EBA Recommendation explicitly called on NSAs to ensure that banks' reduction in RWAs as a means of attaining the set target was achieved only through the sale of selected assets. Disposals of assets stemming from the EBA Recommendation led to a RWA reduction of €77 bn, only 1.6% of the RWAs compared to September 2011. They were mainly disposals of non-core assets in a small number of banks. In particular, a significant component of the asset sales concerned US dollar denominated assets, as a result of the drying up of US dollar funding sources, rather than by capital constraints.

10. Has the Recommendation negatively impacted lending to the real economy?

The short answer is no. Overall, EU banks' new lending levels are driven primarily by credit demand (which is lower, especially in countries experiencing a difficult economy), by banks' need to de-risk and tighten their credit underwriting criteria (seeking to avoid future asset quality problems), by funding shortages, and also by capital constraints. Specifically to the EBA recapitalisation exercise, deleveraging measures agreed as part of the capital plans, and discussed in colleges of supervisors, led to an overall reduction of RWAs of €42.94 bn, only 0.87% of the September aggregate RWAs. Such measures concentrate in a small number of banks that have agreed this reduction with international and EU organisations.

Progress in the implementation of the Recommendation

11. How will the EBA monitor those banks for which backstop measures have been activated by Governments to directly support them?

For those banks for which backstop measures were deemed necessary, the relative Governments committed to providing public backstops. In order to show the Governments' willingness to underwrite the new issuance, the EBA requested a written statement of such commitment, detailing the amount committed and drawing a clear timeline within 2012. In addition, the Consolidating National Supervisor agreed to keep the EBA informed of the progress made on an ongoing basis and to immediately notify the EBA of any change or contingency in this respect.

12. What is the timeline for Cypriot banks to comply with the EBA's Recommendation?

The Cypriot banks in the sample were not able to reach the 9% CT1 target in the private market. Therefore, in June 2012, the Cypriot authorities announced a request for financial support from euro area Member States, through the EFSF/ESM and for international support from the IMF, in the framework of a full assistance programme. The programme will encompass measures to ensure the stability of the financial sector, Actions to carry out the fiscal adjustment to support the ongoing process of fiscal consolidation, and structural reforms. After the announcement by the Cypriot Authorities, the Troika delegation, comprising the EC, the ECB and the IMF, has visited the country. Preliminary discussions leading to an MoU have already taken place and further discussions are expected during October in order to finalise and sign the MoU. Under the support programme, an asset quality review of the Cypriot banks will start very shortly, including a stress test exercise, with the aim to determine the banks' eventual capital needs. The EBA is part of the steering committee for the assessment of Cypriot banks' capital needs.

Transition to CRD IV / New EBA Recommendation

13. Why do we need a new EBA Recommendation?

Although market conditions are improving since the beginning of the recapitalisation exercise in late 2011, the economic environment remains volatile. Moreover, the entry into force of the CRDIV/CRR requirements in 2013 is an important challenge for the EU banking system.

To ensure the EU banking system remains solid and is prepared for the implementation of the CRDIV/CRR requirements, the EBA deemed appropriate to start working on a new Recommendation focusing on capital conservation for the main European banks.

14. Will banks have to maintain a capital ratio of 9% under the new Recommendation considering the forthcoming implementation of the CRDIV/CRR package?

The introduction of CRDIV/CRR in 2013 will change the legal setting for assessing capital levels. In this respect, the EBA will no longer monitor a Core Tier One ratio but a nominal amount of capital. The new EBA Recommendation on capital conservation will require banks to maintain a nominal amount of CT1 capital corresponding to the level of 9% at the end of June 2012.

In specific circumstances, banks may be allowed to go below the absolute amount of capital requested but only in such cases as restructuring plan or de-risking process. For example, a sale of a subsidiary agreed as part of a restructuring plan could be accompanied by a reduction in the need to hold capital against that subsidiary. Such measures will have to be included in the capital plans submitted by banks and finally agreed by national supervisors. Banks will be expected to refrain from using capital for strategic purposes or dividend payments and variable remuneration unless it is agreed that they are fully on track to comply with the CRD IV/CRR framework.

Final provisions will be detailed in the new Recommendation to be adopted by the EBA once the CRD IV/CRR package is adopted.

15. How will the monitoring of the capital plans be done under the new Recommendation on capital conservation?

Banks will be required to submit capital plans to their competent supervisor. Plans would be shared within colleges of supervisors and with the EBA. The monitoring of the capital plans will be done both in normal times and under stressed conditions.

Final provisions regarding the monitoring of the capital plans will be detailed in the new Recommendation to be adopted by the EBA once the CRD IV/CRR package is adopted.

16. Will banks also need to maintain the sovereign buffer?

The sovereign component of the capital buffers remains in force at September 2011 level until withdrawn and it will be considered separately depending on the market environment.

Disclosure

17. What is the EBA disclosing today?

The current report presents both the overall banks' strengthening of their capital positions in response to the EBA's Recommendation as well as the individual CT1 capital levels as of June 2012. Furthermore, to ensure maximum transparency, the EBA is also disclosing additional individual data on banks' composition of capital, RWAs and sovereign exposures, both as of December 2011 and June 2012.

18. Why are you disclosing individual data for only 61 banks?

The initial sample of the Capital Exercise included 71 banks. However, the 6 Greek banks were treated separately as the country is currently under an EU/IMF assistance programme. Moreover, 4 banks (Österreichische Volksbank AG, Dexia, WestLB AG and Bankia) from the original sample have been identified as undergoing a significant restructuring process, and are being monitored separately. Therefore, the individual disclosure refers to 61 banks.