



EUROPEAN CENTRAL BANK

EUROSYSTEM

State of play of the Comprehensive Assessment and the overall SSM preparations

Presentation by D. Nouy, Chair of the Supervisory Board

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Agenda

1 State of play of the Comprehensive Assessment

2 Overview of the state of SSM preparations

The Comprehensive Assessment is a key priority for the ECB prior to the operational start of the SSM in November 2014

Asset Quality Review

- Assessment of data quality, asset valuations, classifications of non-performing exposures, collateral valuation and provisions
- Covering credit and market exposures, following a risk-based, targeted approach

Joint ECB/ EBA Stress Test

- Forward-looking view of banks' shock-absorption capacity under stress
- Conduct in collaboration with the European Banking Authority

The exercise is at an advanced stage: numerous important milestones have been reached since its kick-off in November '13

- **Project mobilisation at the national and central level:** Establishment of governance and project management structures, procurement of relevant third party-support.
- **Portfolio-selection process:** Risk-based selection of portfolios subject to examination.
- **Determination and communication of main features of the stress test in cooperation with EBA:** Key aspects of methodology and scenarios published on 31 January and 29 April.
- **Methodology for the AQR execution phase:** Methodological manual for phase 2 of the AQR published on the ECB website on 11 March.
- **Coordination between home and host supervisors:** Establishment of arrangements for cross-border cooperation in the AQR execution.
- **AQR data requests:** All data templates finalised, also making use of field-tests with banks to ensure feasibility. Data collections largely completed at this stage.
- **AQR execution:** On-site work of bank inspection teams at a very advanced stage, with majority of work blocks complete or close-to completion. Strong focus on quality assurance.
- **Disclosure templates for CA results:** Publication on 17 July after consultation with banks.
- **AQR-stress test join-up:** Development of specific join-up methodology close to completion.

The AQR data collections have been almost fully completed at this stage

The templates used were carefully designed so as to balance adequate granularity and feasibility, also making use of field-testing for refinement

Example Template: T4A

- T4A is a data collection template to be populated by the banks for each debtor selected for the credit file review
 - It provides the basic information required by NCA Bank Teams to perform the credit file review
 - By collecting the relevant information into one place it increases the efficiency of the credit file review for the NCA Bank Team and reduce the need for banks to respond to questions on detailed credit files

Steps taken to address concerns on T4A

- As many fields as possible have been marked as non-compulsory
- All fields allow “unknown” to be entered to allow significant banks not to populate if the data are not available or is judged too difficult to obtain given the time burden implied and level of importance for that specific debtor – **this will not automatically impact the assessment of the debtor negatively**
- Some specific fields which have been raised in comments as less important have been deleted

Execution of the AQR work blocks in general is at a very advanced stage

Work blocks/milestones which have been completed

- Generation and submission of bank loan tapes
 - Data Integrity Validation of loan tapes
 - Processes, Policies and Accounting Review
 - Submission of credit files by banks
 - Core Trading Book Processes Review
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Work blocks/milestones which are approaching completion

- Collateral Valuation
 - Credit File Review
 - Revaluation of Non-Derivative Level 3 Assets
 - Level 3 Derivative Pricing Model Review
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Ambitious timelines and data requirements form an indispensable part of the exercise

- The Comprehensive Assessment is a one-off exercise of unprecedented scope whose success requires exceptional contributions by all parties involved;
- Significant efforts required from banks in this context are clearly recognised;
- Methodological elements and data requests were designed carefully to avoid any unnecessary burden (e.g. field-testing and streamlining of templates to the extent possible);
- The scope and granularity of the exercise are strictly necessary to achieve the goals of establishing transparency on the condition of bank balance sheets and restoring confidence in the European banking sector.

Communication of the Comprehensive Assessment results and relationship between Comprehensive Assessment and SREP decision 2014

- Partial and preliminary findings of the Comprehensive Assessment will be communicated to banks for fact checking purposes before the finalisation and publication of the results.
- A consultation period with banks on the bank-level templates to be used for the disclosure of final results ended on 8 July, with publication taking place on 17 July.
- The results of the Comprehensive Assessment will be disclosed to the public simultaneously for all banks included in the exercise before the ECB assumes its supervisory tasks and powers.
- Banks facing a capital shortfall will be asked to submit capital plans on short notice after the disclosure. Capital shortfalls will be expected to be covered within six months for those identified in the AQR or the baseline stress test scenario, and within nine months for those identified in the adverse stress test scenario.
- The results of the Comprehensive Assessment and the capital plans provided by banks will feed into the SREP Decision 2014. Nevertheless, the SREP capital decision can be more demanding than the Comprehensive Assessment due to its broader scope.
- For the SREP decision the legal procedure foreseen in the Framework Regulation will apply.

The Stress tests: the Scenario building process

- The baseline scenario was prepared by the European Commission
- The adverse scenario was proposed by the ESRB, working in close collaboration with the ECB and the EBA, and it was finally approved by the EBA Board of Supervisors
- It captures the prevailing view of systemic risks facing the EU financial system, as identified by the ESRB General Board
- It includes forward-looking paths for key macroeconomic and financial variables for all EU countries and a large number of non-EU countries over a three-year horizon

Scenario building blocks: four main sources of risk

Source of risk:	Financial and economic shocks:
<p><u>Increase in global bond yields</u> amplified by an abrupt reversal in risk assessment, including towards EMEs, and pockets of market liquidity</p>	<ul style="list-style-type: none"> • Financial market shocks worldwide (sovereign bonds, corporate bonds, stock prices, etc.). • Demand shocks in EMEs • EU countries: foreign demand shocks via a decline in world trade • Currency depreciation and funding stress in CEEs
<p><u>Further deterioration of credit quality in countries with feeble demand, with weak fundamentals and still vulnerable banking sectors</u></p>	<ul style="list-style-type: none"> • EU country-specific aggregate demand shocks (via fixed capital formation and private consumption) • EU country-specific aggregate supply shocks (via shock on user cost of capital, nominal wages) • EU country-specific house price shocks
<p><u>Stalling policy reforms</u> jeopardising confidence in the sustainability of public finances</p>	<ul style="list-style-type: none"> • EU country specific sovereign bond spread shocks
<p><u>Lack of necessary bank balance sheet repair</u> to maintain affordable market funding</p>	<ul style="list-style-type: none"> • EU-wide shock to short-term interbank interest rates • EU country-specific shocks to borrowing costs for households and corporates (via shocks to respectively, wealth and user cost of capital)

Scenario narrative

- Starting point: global sources of risk
 - Increased risk aversion, broad-based sell-offs and re-pricing
 - EMEs specifically impacted, with a severe decline in world trade
 - Currency depreciation and funding stress in CEEs
- Triggering EU-specific risks
 - Domestic demand confidence-driven shocks (real estate too)
 - Sovereign bond yield differentiation re-appearing
 - Access to and costs of bank funding impacted

Where banks' capital ratios fall short of the relevant thresholds, remedial actions will need to be taken

Banks will be requested to submit capital plans detailing how the shortfalls will be covered

Time frame for covering shortfalls

- Depending on the source of the shortfall:
 - Six months for shortfalls identified in the AQR or the baseline stress test scenario
 - Nine months for shortfalls identified in the adverse stress test scenario
- The periods of six or nine months will start from the release of the comprehensive assessment results in October 2014

Recapitalisation measures

- Capital plans should focus on private sources of funding:
 - Retained earnings,
 - Reduced bonus payments,
 - New issuances of common equity
 - Suitably strong contingent capital,
 - Sales of selected assets at market prices
 - Reductions of RWAs associated with restructuring plans agreed with the European Commission

The use of convertible capital instruments to cover shortfalls will be subject to limits (1/2)

- Shortfalls revealed by the AQR or the baseline scenario of the stress test may only be covered with Common Equity Tier 1 (CET1) capital instruments
- Shortfalls arising from the adverse scenario of the stress test may be covered with CET1 instruments and/or convertible or write-down instruments meeting the requirements of Article 52 of the CRR (i.e. Additional Tier 1 instruments)
- The use of Additional Tier 1 instruments is limited to a maximum of 1% overall RWA, subject to the following specifications:

Level of conversion trigger	Below 5.5% CET1	Above 5.5% and below 6% CET1	above 5.5% and below 7% CET1	At or above 7% CET1
Maximum amount of shortfall that can be covered by the instrument	0% of overall RWA	up to 0.25% of overall RWA	up to 0.5% of overall RWA	up to 1% of overall RWA

The use of convertible capital instruments to cover shortfalls will be subject to limits (2/2)

- Treatment of existing convertible instruments that are subject to unconditional pre-defined conversion into CET1, and state aid instruments used by Member States in the context of financial assistance programmes is described in the published note

Example for the use of AT1 instruments to cover a shortfall:

- *The CET1 of an institution falls to 4% of RWA under the adverse scenario of the stress test, which means a shortfall equivalent to 1.5% of RWA. The institution had previously issued AT1 instruments with different triggers (CET1 ratio of 5.75%, 6.5% and 7%).*
- *The AT1 instruments with a trigger at 5.75% may be used to cover the shortfall up to a maximum of 0.25% of RWA.*
- *The use of the AT1 instruments with a trigger at 5.75% and 6.5% is limited in total to 0.5%. If the limit for the 5.75% AT1 instruments has already been reached, the use of the AT1 instruments with a trigger at 6.5% is limited to 0.25%.*
- *The AT1 instruments with a trigger at 7% CET1 may be used to cover up to 1% of RWA. If the institution has fully utilised the limits for the AT1 instruments with lower triggers, it may cover 0.5% of RWA with these instruments.*

Agenda

1 State of play of the Comprehensive Assessment

2 Overview of the state of SSM preparations

SSM preparations are at an advanced stage, on track for finalisation by 4 November 2014

Preparations have largely been organised within five major strands of work, carried out in close cooperation between ECB and the National Competent Authorities:

- Mapping of the SSM Banking System
- Supervisory Legal Issues (SSM Framework Regulation was published on 25 April)
- Supervisory Model
- Supervisory Reporting Framework
- Comprehensive Assessment of credit institutions

ECB-internal preparations have been running in parallel:

- Creation of the organisational structures for the new supervisory function
- Recruitment process for staff in supervision and support functions
- Establishment of IT infrastructures
- Selection of premises for the new supervisory function
- Creation of a coordinated communications network spanning all elements of the SSM

Several key milestones are to be completed over the next months

- **Adoption of the list of significant institutions**
 - Assessment of significance to be based on data as of year-end 2013;
 - Draft list of significant institutions has been published on ECB website and the respective institutions (group heads) have been notified by letter

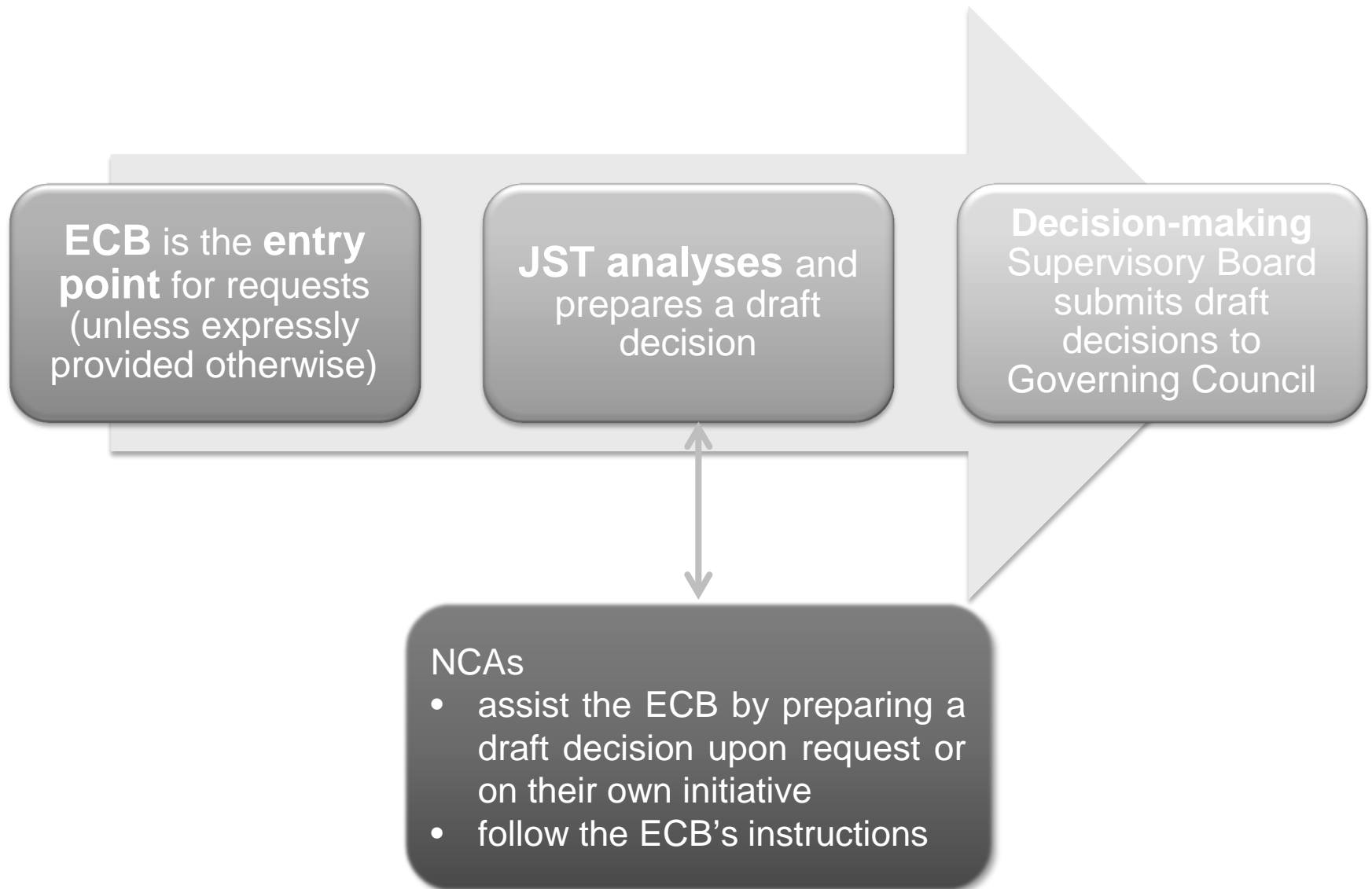
- **Completion of the recruitment process for supervisory staff**
 - The four Directors General in charge of micro-prudential have been nominated and have already commenced their work;
 - Most of the middle management for supervisory functions has been recruited;
 - Recruitment of staff on expert level is on-going;

- **Completion of the Comprehensive Assessment before 4 November 2014**
 - Outcomes to be published before the operational start of SSM supervision.

Overview of main elements of the SSM Preparatory Work

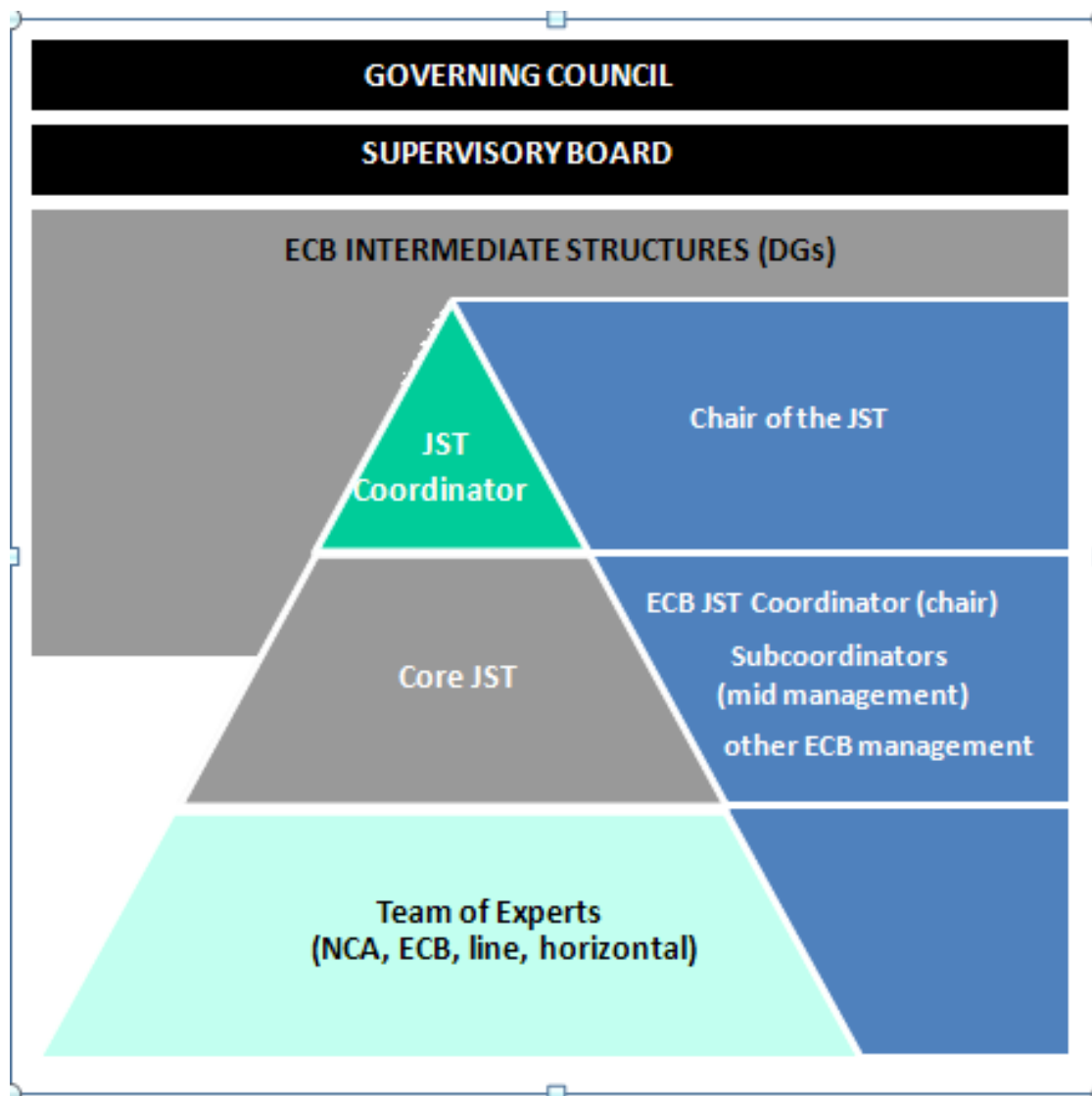
SSM Preparations				
<i>Mapping of the SSM Banking System</i>	<i>Supervisory Legal Issues</i>	<i>Supervisory Model</i>	<i>Supervisory Reporting Framework</i>	<i>Comprehensive Assessment</i>
Mapping of banking group structures and collection of the data necessary for the identification of significant institutions	Development of the SSM Framework Regulation and legal advice on the preparatory work for setting up the SSM	Development of the SSM supervisory model and description of its key aspects in the Supervisory Manual	Review of the existing supervisory reporting models as a basis for the development and design of the SSM reporting framework	Asset quality review; stress test and supervisory risk assessment of potentially significant institutions

Supervision of significant banks



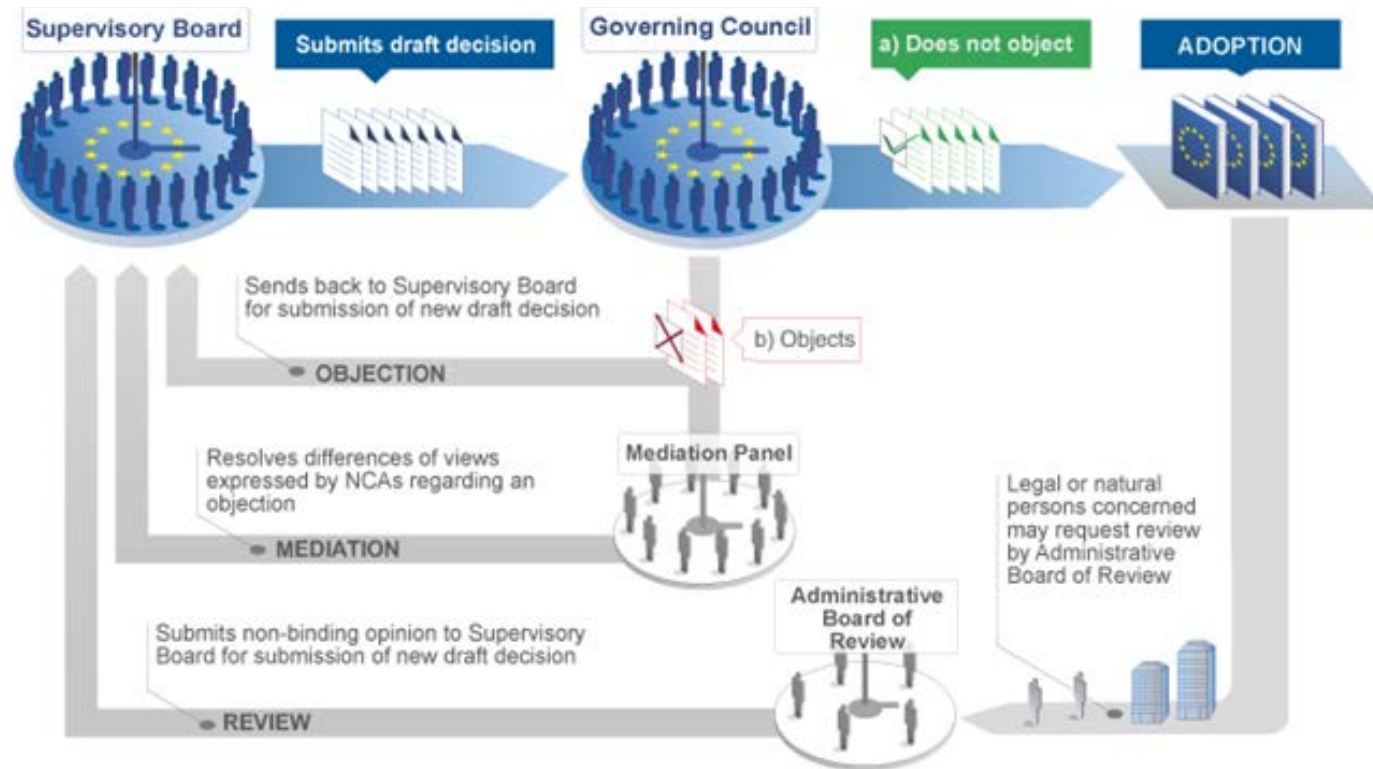
Joint Supervisory Teams functioning

- Established for every significant banking group, comprising staff from ECB and NCA
- Responsible for day-to-day supervision of individual significant institutions and for implementing the annual supervisory programme
- Responsible for implementing decisions of Supervisory Board/Governing Council
- Size and composition of JSTs vary between institutions



Decision-making process

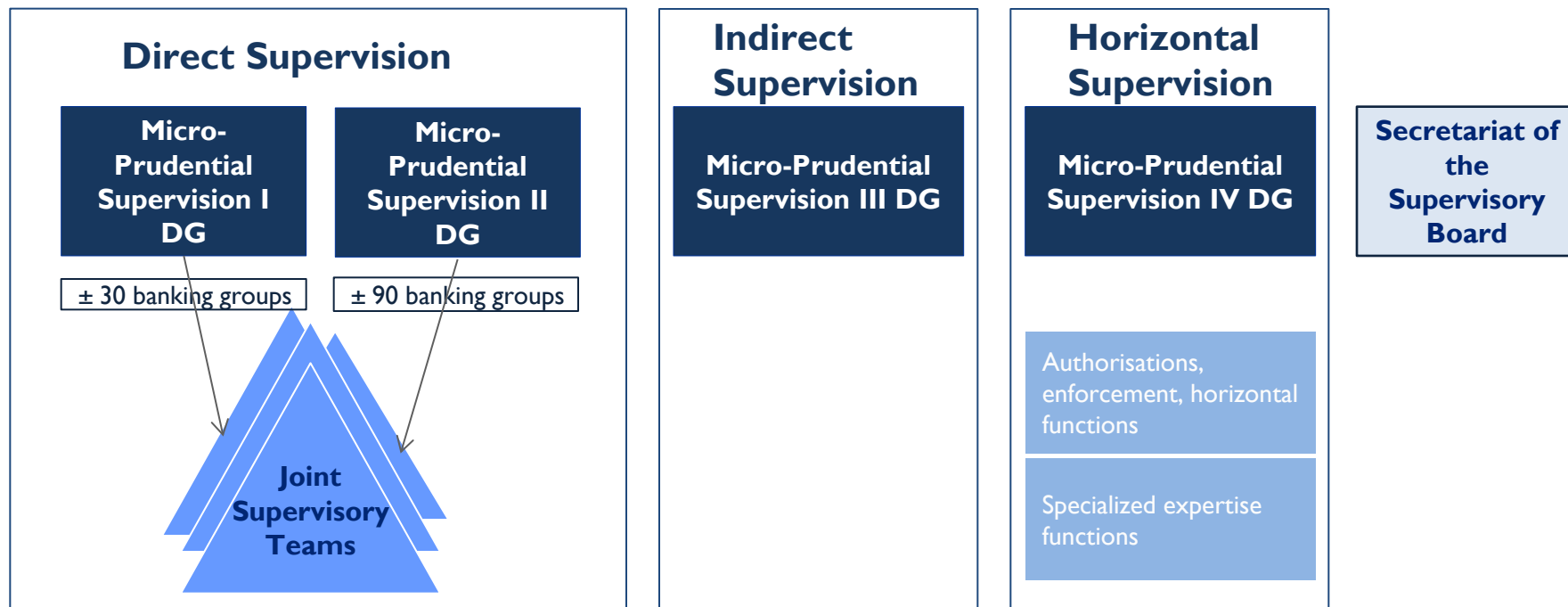
Decision-making in the **Single Supervisory Mechanism** will be based on a new procedure known as the “**non-objection**” procedure.



- The Supervisory Board will propose draft decisions to the Governing Council of the ECB. If the Governing Council does not object to the draft decision within a defined period of time, the decision will be deemed adopted.

Internal organisation of the ECB supervisory functions

Micro-prudential supervision



Joint Supervisory Teams (JSTs) as main tool to conduct the day-to-day supervision of significant banks