

QUESTIONS & ANSWERS

Process

1. Q. Why has the EBA undertaken a recapitalisation exercise?

- A. 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 comprehensive 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. Q. Overall did the recapitalisation exercise achieve its goals?

- A. During the second half of last year the global markets were extremely concerned about EU banks' level of capital, which they deemed insufficient faced with the worsening sovereign financial situation, as well as with funding shortages. While the latter challenge was significantly mitigated by the ECB's LTROs, the former was addressed by the EBA recapitalisation exercise. The EBA exercise led to a significant increase in the aggregate capital for those participating banks which needed to achieve the 9% CT1 by end-June 2012. 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. It may be followed, where needed, by a thorough bank-by-bank asset quality review by national supervisory authorities, to include both a reassessment of the loan portfolios' loss contents and of collateral valuations. Successful completions of these steps should be able to unlock both long-term funding markets and cross-border interbank markets.

3. Q. Isn't a recapitalisation exercise leading to banks being more reluctant to lend?

- A. 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.

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

- A. 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.

5. Q. What distinct roles did the EBA and the competent national authorities play in reviewing and implementing the capital plans?

- A. The recapitalisation exercise was launched and coordinated by the EBA in close cooperation with the competent national authorities. 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 ensure 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 in more 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. No assessment of assets quality was undertaken by the EBA as this was beyond the scope of the exercise, and remains in the responsibility of national authorities.

6. Q. Why is the list of banks covered by this report different to the initial sample?

- A. Out of the 71 banks participating in the capital exercise, 31 banks resulted in an initial shortfall to meet the 9% core tier 1 ratio. However, three banks (Österreichische Volksbank AG, Dexia and WestLB AG Düsseldorf) are currently involved in deep restructuring, with a wind down of their activity which the EBA has agreed is an appropriate response to the December Recapitalisation Recommendation. Moreover, in May, the Spanish authorities announced that

Bankia would go through a deep restructuring process. Therefore, Bankia is not included in the current report and will be monitored separately by the Spanish authorities in conjunction with the European Commission and liaising with the ECB, the EBA and the IMF. This report therefore covers 27 banks.

Progress in the implementation of the Recommendation

7. Q. How will the EBA contribute to monitoring those banks that are under special programs or undergoing major restructuring?

A. As clearly provided for in the EFSF Guidelines on Recapitalisation of Financial Institutions via loans to non-programme countries, the EBA is called to liaise with the EU Commission at various stages of the recapitalisation process. Therefore, the EBA will play an important role in a number of key aspects related mainly to the eligibility for and the amount of the facility, the preparation of institution specific conditionality, and the monitoring of banks' compliance with the set conditions.

8. Q. How did the EBA assess those banks for which backstop measures have been activated by Governments to directly support them?

A. For those banks for which backstop measures were deemed necessary, the EBA ensured that a written statement be published clearly showing the government's willingness to support the institutions underwriting the new issuance as well as detailing the amount committed and the timeline. A clear reference to this timeline will be made in the September report. The EBA also asked the national competent authorities to be kept abreast, on an ongoing basis, of the progress made and to be immediately notified of any change or contingency plan in this respect.

9. Q. Will banks have to maintain the capital level required by the Recommendation after July?

A. The Recommendation will remain into force until rescinded. Work is currently underway to map the transition from the recommendation to the future regulatory framework of CRD4-CRR. The key principle will be to ensure capital conservation in 2013 and beyond that date, while banks progress in their plans to align their capital levels with the requirements set in CRD4-CRR at the end of the implementation phase (2019).

Outcome

10. Q. 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”?

A. 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, the other

mitigating measures on RWAs have reduced them by 0.62% compared to September. These measures mainly consist of improvement of assets quality – including through collaterals and guarantees – and impacts stemming from the application of CRD 3.

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

A. 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 €90 bn, only 1.8% 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.

12.Q. Has the Recommendation negatively impacted lending to the real economy?

A. 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 €30.3 bn, only 0.62% of the September aggregate RWAs. Such measures concentrate in a small number of banks that have agreed this reduction with international and EU organisations. Also the BIS quarterly review, published in 2012, showed that despite the strong pressure for deleveraging in Europe during the final quarter of 2011 – and the consequent freeze of the markets for medium and long term bank funding – there is no evidence that the deleveraging process has become excessive or disorderly, with disruptive consequences on the real economy.

Disclosure

13.Q. What are the figures being disclosed today?

A. In line with the overview report published last February, the current report provides an aggregate picture of banks' ability to fill the identified shortfall and indicates the main drivers underlying banks' strengthening of their capital positions. A bank-by-bank report will be published in September.