



Opening Statement
Publication of the 2011 EU-wide Stress Test Results
Andrea Enria, Chairperson of the European Banking Authority
London, 15 July 2011

We are here today to present you with the results of the EU wide stress test carried out by the EBA with national supervisors across 90 banks in 21 countries. This comprehensive analysis has been completed to deliver unprecedented transparency about the EU banking system and in turn reduce market uncertainty. The exercise has been consistently applied and banks have been stressed against a stronger capital benchmark of 5pc Core Tier One. All vulnerabilities must be addressed at national level and action plans undertaken by banks and national authorities; the EBA will then conduct a thorough review of the follow-up actions undertaken.

INTRODUCTION

Let me remind you what a stress test is – a “what if” analysis using hypothetical scenarios, set at a point in time against a methodology and set of benchmark assumptions. It is designed to be deliberately severe. It is not a forecast. A stress test is one of a number of important supervisory tools. It is not a guarantee of the safety of individual institutions, but part of an ongoing process to identify and reduce vulnerability. We have been very clear since the beginning of this process that this stress test is also not about simply passing or failing against a particular capital benchmark. It is a supervisory tool to assess the resilience of a large sample of banks against a common test that models an adverse but plausible scenario.

Today’s publication provides unprecedented transparency and disclosure for the market to make its own judgement. It gives access to the data they need to make informed decisions about the exposure to the risk of 90 EU banks. To put this in

context, there are some 3,200 data points in today's results compared to just 149 in last year's CEBS run test. In some cases the information might not be completely consistent across countries, due to different definitions or national treatments but we have sought to explain this in the report and published template.

The adverse scenario was set on an agreed set of risks at December 2010 by the ECB using Commission forecasts from Autumn 2010 as the baseline. The adverse macroeconomic scenario for the EU as a whole is still quite severe in light of recent developments, but clearly the sovereign debt situation has moved on since the scenario was set. Although we have taken this into account in the guidance issued to banks in early June, we are aware that the risk outlook for European banks has significantly deteriorated in recent weeks.

OUTCOME

The results presented show the impact of the stress test on the static balance sheet at end 2010 and also show the impact of actions to increase capital in the early months of 2011 which have already strengthened the position of the banking sector. The plain result of the stress test applying the shock to end-2010 balance sheets shows that 20 banks fall below the 5% CT1 threshold in the two years horizon of the stress test. The overall shortfall total for the plain stress test is EUR27bn.

However this is not the full picture as banks have acted pre-emptively (by end April) to ensure they passed the test. Taking this into account we are now presented with a much better result and fuller picture – so the results we are presenting today show that eight banks would not meet the capital benchmark by end December 2012. The overall shortfall is also contained, at EUR2.5 bn.

The approach adopted by the EBA opened a window which gave banks until end April 2011 to strengthen their capital position: this took into account issuance of fresh Core Tier 1 capital, conversion of lower quality capital instruments into Core Tier 1 and restructuring plans fully committed and approved by all competent authorities were allowed to be factored into the results. It provided banks with a strong incentive to act with a view to avoid falling below the capital threshold set in the exercise. Considerable actions have been taken. We noticed a cluster of board

meetings in the days before 30 April taking decisions to raise Core Tier 1 capital levels: the aggregate **Core Tier 1 in the sample of banks increased by EUR50bn in the first four months of 2011.**

The stress test has been run in a very rigorous way. This can be seen by looking at the development of impairments and profits. **Under the adverse scenario losses would be approximately EUR400bn in the two year horizon of the exercise.** This would amount to having the same amount of losses registered in 2009, the worst year for the banking industry, for two years in a row. This would amount to having the same amount of losses registered in 2009, the worst year in recent history, for two years in a row. We should also remind that this outcome would be realised in a relatively mild recession, as the adverse scenario entails a severe deviation of GDP growth from the baseline (-4% in the two years) but not a major drop in macroeconomic activity. Also pre-impairment income would significantly decrease, at levels almost 30% below those of 2009 and 2010.

Therefore, as a result of capital raised in early 2011, EU banks are clearly in a better position now to absorb shocks. Nonetheless, the EBA's view is that this is a necessary but not sufficient step towards ensuring the robustness of the EU banking sector. Therefore, the EBA has made additional recommendations to address vulnerabilities in banks above the threshold which I will explain in detail.

QUALITY ASSURANCE & PEER REVIEW

Achieving consistent results and implementation of the agreed methodology, proved one of the greatest challenges of this test. Three rounds of peer review were required to reach an acceptable level of consistency across the piece, by means of additional guidance and challenging banks' assessment. For the first time in the EU, a task force of EBA staff - experts from national supervisory authorities, the ECB and the ESRB - has been able to review and challenge very confidential data of all banks in the sample. Results have been checked against a series of benchmarks - internal consistency, historical experience, evidence at peer banks, etc. When the overall results were deemed to err on the side of optimism, the EBA developed conservative floors or caps, as for instance in the treatment of sovereign exposures in the banking book, which has been pegged to independent assessments of credit rating agencies.

We have to remind you that this is a bottom up exercise, conducted by the banks in most cases using their own internal models. The estimates of risk parameters by banks are sometimes very diverse, also for exposures in the same portfolio and against counterparties in the same country. Although the EBA took action to achieve greater consistency and more rigorous estimates. More work on this issue is needed in the future.

SOVEREIGN TREATMENT

We are aware that the treatment of sovereign exposures is very contentious and the stress test itself is not designed to deal directly with every twist and turn in the crisis to deal with the sovereign debt issue. We believe our treatment is rigorous and still consistent with recent developments. Haircuts to the trading book and conservative floors to provisioning levels for exposures in the banking book have been applied. Direct exposures to the sovereigns experiencing the most severe widening of credit spreads, Greece, Ireland and Portugal, is concentrated in the banks of those countries. It is clear that for these banks a higher capitalisation is warranted. All of these countries are already implementing IMF-EU programmes and action has already been taken to ensure that higher capital levels are achieved.

CONCLUSION

The capital position of European banks has been strengthened significantly after the stress test conducted by CEBS last year. The banks in the sample increased their reserves by EUR50 billion in the accounts 2010 and increased their position in terms of Core Tier 1 capital by around a further EUR50 billion in the first months of 2011. This has been the result of the coordinated pressure exercised by EU supervisors and the stress test has surely been a catalyst in this process.

With this stress test the EBA has provided unprecedented disclosure to the market to increase transparency. The EBA understands that some uncertainty as to the strength of the capital position of EU banks stems from the lack of detailed and comparable information across countries. The EBA believes that transparency contributes to, rather than detracts from, orderly market functioning. Today, we are providing a reasonable level of insight into the current credit risk and capital

cushions carried by lending institutions across Europe for a clear and structured analysis of where we stand.

The results provide us with some important reassuring messages. But, we must not be complacent.

The EBA is acutely aware that the EU banking sector is under severe strain at the time of publication. The sovereign debt situation unfolding in the EU creates specific pressures. While the adverse scenario is still consistent with the current situation and in line with EU commitments not to let one of its Member States default on its liabilities, a further deterioration in the sovereign crisis might raise significant challenges, also through sharp changes in investors' risk appetite and pressures on banks' funding.

National supervisors should make sure that all steps are taken to ensure that capital positions are further strengthened.

As a result, the EBA has today issued a recommendation for those national authorities to implement. Where a core tier one ratio falls above the benchmark but close to 5pc and a bank has sizeable exposures to sovereigns under stress, the supervisor must oversee that it takes specific steps to strengthen its capital position, including where necessary restrictions on dividends, deleveraging, issuance of fresh capital or conversion of lower quality instruments into core tier 1 capital.

These banks and those under the 5pc core tier one requirement will be expected to plan remedial action within three months (15 October 2011); the banks under 5% will need to take action by end 2011, while those above but close to the threshold will have a longer time span available, and action these plans within nine months by April 2012. The EBA will report on progress in this regard and will review the actions undertaken by banks and national authorities between August and December 2011 and will publish reports in February and June 2012 on the implementation of these recommendations.

I now open the press conference to questions.

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