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Report on the fulfilment of the EBA Recommendation following the 2011 EU-wide stress test

Executive summary

Following the publication of the 2011 EU-wide stress test results in July 2011, the EBA issued a Recommendation to national supervisory authorities (NSAs) to ensure that appropriate mitigating actions were put in place with respect to (i) banks with a Core Tier 1 capital (CT1) ratio below 5% in the adverse scenario and (ii) to banks with a CT1 ratio close to 5% in the adverse scenario and with sizeable exposures to sovereigns under stress.

Forward looking mitigating measures were identified in the publication templates for relevant banks to address weaknesses. The EBA, as a part of its ongoing monitoring activities, has continued to assess the implementation of these mitigating measures against the requirements of the EBA Recommendation.

NSAs responsible for the supervision of the banks falling under the scope of the EBA Recommendation have provided the details of the mitigating measures taken for the respective banks and of their close monitoring of banks as a part of ongoing supervisory activities.

In total, eight banks of the 90 participating in the EBA 2011 stress test exercise had a CT1 ratio under the adverse scenario below the set 5% benchmark. According to the information provided to the EBA, mitigating measures have been put in place for all banks with a post stress capital ratio below 5%, and were deemed sufficient by the EBA to comply with its Recommendation. Following a deterioration of the external environment, in many cases, additional measures have been put in place by NSAs which the EBA notes and supports. In some cases, these actions are ongoing and NSAs have confirmed to the EBA that the mitigating actions are being closely followed under national initiatives and will be finalised within reasonable timelines agreed between banks and their respective NSAs.

Most of the banks with a CT1 ratio above 5% and with sizeable exposures to sovereigns under stress will be addressed under the monitoring of the December 2011 Recommendation following the results of the 2011 EU Capital exercise, where they have been included in the sample of 71 banks.

The EBA is, in general, satisfied with progress in the fulfilment of the July 2011 Recommendation noting the actions that have been taken that include capital strengthening and adequate recognition of losses. In addition, those banks identified as having weaknesses have subsequently undergone restructuring processes and will no longer exist in the same form as at the moment of the stress test.

Some of the banks falling under the scope of the July 2011 Recommendation and the December 2011 Recommendation are subject to the implementation of more stringent measures under the pre-agreed EU/IMF assistance programmes and to a separate monitoring by the so called "Troika" authorities (EU Commission, ECB, IMF).

Background and introduction

The results of the second EU-wide stress tests conducted by the European Banking Authority (EBA) in cooperation with the EU Commission, European Systemic Risk Board (ESRB), European Central Bank (ECB) and national supervisory authorities (NSAs) were published in July 2011[1]. The aim of the stress test was to assess the resilience of 91 participating banks from 21 EEA countries against an adverse but plausible scenario. The aggregate Core Tier 1 (CT1) ratio of the 90 banks that published information in the 2011 EBA stress test decreased from 8.9% to 7.7% after two years of stress. The largest driver of the decrease is impairment charges which led to CT1 decrease of 3.6 percentage points.

As a result of the application of the adverse macro-economic scenario and common constraining assumptions applied in the exercise, the post stress capital ratios of eight banks fell below the capital threshold set at the level of 5% CT1 with the overall capital shortfall of EUR 2.5 bn based on the EBA definition of CT1. In addition, 16 banks displayed post stress CT1 ratios between 5 and 6% after the application of the adverse scenario over the two-year time horizon.

On the basis of the results of the stress test, the EBA issued its first formal Recommendation addressed to NSAs and requiring remedial actions. In particular, pursuant to Article 21.2(b) of the EBA Regulation, the Recommendation published as a part of the EBA Aggregate report[2], states the following:

a. NSAs to request banks whose CT1 ratio falls below the 5% threshold under the adverse scenario defined in the stress test exercise to promptly remedy this capital shortfall. In particular, national supervisors should ensure that these banks are requested to present within three months (i.e. by 15 October 2011) to their competent authorities a plan to restore the capital position to a level at least equal to the 5% CT1 benchmark based on this analysis. The remedial measures agreed with the competent authority had to be fully implemented by end of 2011, with flexibility allowed only if justified by market conditions or required procedures.

b. NSAs to request all banks whose CT1 ratio under the adverse scenario is above but close to 5% and which have sizeable exposures to sovereigns under stress to take specific steps to strengthen their 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 were expected to plan remedial action within three months. The plans had to be fully implemented within nine months from the publication of the stress test results.

[1] See: http://eba.europa.eu/EU-wide-stress-testing/2011/2011-EU-wide-stress-test-results.aspx
[2] See: http://stress-test.eba.europa.eu/pdf/EBA_ST_2011_Summary_Report_v6.pdf

With the publication of these Recommendations, the EBA committed to reviewing their fulfilment and to publishing the outcomes of such review.

This report directly addresses the fulfilment of the first part of the July 2011 Recommendation (banks failing to meet the 5% CT1 threshold), whereas the second part will be followed–up under the December 2011 EU Capital exercise Recommendation.

Link to the 2011 Capital exercise

Following the further escalation of the sovereign debt crisis, and the announcement of the European coordinated policy package on 26 October 2011, the EBA has conducted a Capital exercise amongst 71 banks aimed at assessing banks recapitalisation needs after the prudential revaluation of the sovereign exposures and at applying higher capital threshold set at 9% CT1.

It should be noted that the EBA Capital exercise was not a stress test. Against the ongoing developments in the markets and the deterioration of the sovereign debt crisis in Europe, the EBA reviewed banks' actual capital positions and sovereign exposures as of September 2011 and requested them to set aside additional capital buffers. The capital buffer is designed to provide reassurance to markets about the ability to withstand a range of shocks and still maintain adequate capital.

Following the outcomes of the Capital exercise, the EBA has issued its second Recommendation requiring banks failing to meet the capital threshold to ensure that appropriate mitigating measures are put in place and that by 30 June 2012, all 71 banks attain and maintain until such time as this Recommendation has been amended, repealed or cancelled, the temporary capital buffer at a level of 9% CT1 (December 2011 Recommendation).

To this end, the NSAs have been recommended to ensure that all banks build a temporary capital buffer to reach a 9% CT1 ratio by 30 June 2012, after the removal of the prudential filters on the sovereign assets in the available-for-sale portfolio and the conservative valuation of sovereign debt exposures in the held-to-maturity and loans and receivables portfolios, reflecting market prices as of 30 September 2011[3].

Pursuant to this Recommendation, the EBA has set up a series of follow-up steps requiring banks with a capital shortfall to present the recapitalisation plans outlining the measures they plan to take in order to meet the 9% CT1 capital threshold by 30 June 2012. Such recapitalisation plans have been scrutinised by the respective consolidating NSAs in close cooperation with the Colleges of Supervisors and the EBA.

The December 2011 Recommendation effectively augments the outcomes of the 2011 stress tests. Therefore, the mitigating efforts for banks falling under the second part of the July 2011 Recommendation (banks close to the threshold but with sizable exposures to sovereigns under stress), will be monitored under the December 2011 Recommendation and are not discussed in this report.

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[3] EBA Recommendation on the creation and supervisory oversight of temporary capital buffers to restore market confidence (http://stress-test.eba.europa.eu/capitalexercise/EBA%20BS%202011%20173%20Recommendation%20FINAL.pdf)

Methodology for assessing the fulfilment of the Recommendation

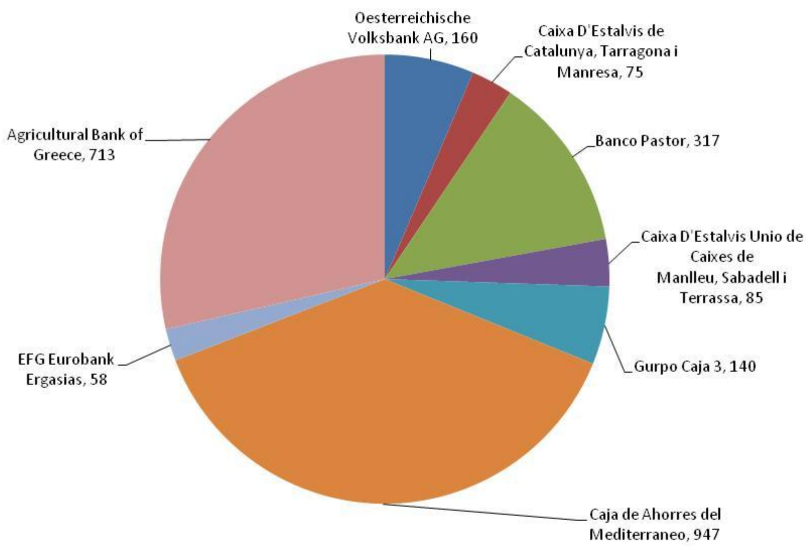
The assessment of the fulfilment of the July 2011 Recommendation is based on the information on mitigating measures provided to the EBA by the consolidating NSAs of the banks failing to meet the capital threshold. The assessment is based on recalculating the CT1 ratio under the adverse scenario for 2012 adjusting risk weighted assets (RWA) and CT1 capital according to the mitigating actions reported by NSAs (either in a separate communication or in the stress test disclosure templates). This assessment is based on the information collected during the stress tests as well as on additional information on the mitigating measures provided by the NSAs without recalculating possible impacts of the stress or taking into account actual financial or portfolio information.

Some of the banks subject to the July 2011 Recommendation are undergoing deep restructuring as part of the pre-agreed measures under EU/IMF programmes. This directly affects the Greek banks, where quantitative capital targets stemming from the pre-agreed EU/IMF programmes exceed the results of the EBA EU-wide stress tests and the EU Capital exercise. The implementation of EU/IMF measures and fulfilment of capital targets is being closely followed by the respective national authorities together with the EU Commission, ECB and IMF.

Fulfilment of the Recommendation by banks below 5% CT1 threshold

In total, eight out of the 90 banks that published the results of the 2011 EU-wide stress test have a CT1 ratio under the adverse scenario that falls below the threshold of 5%. The aggregate CT1 capital shortfall for these banks amounted to EUR 2.5 bn (see Chart 1).

Chart 1: Breakdown of total shortfall (in mln)



When analysing the impact of the mitigating measures put in place after the stress test, it should be noted that most of the banks with a shortfall have gone or currently are undergoing restructuring processes and will no longer exist in the same form as at the moment of the stress test.

Austria

The Oesterreichische Volksbanken AG (OeVAG) submitted a detailed restructuring plan to the Austrian NSAs to promptly remedy its capital shortfall and has already completed a major step: the closed sale of its international operations (Volksbank International AG) to the Russian Sberbank. Furthermore, OeVAG currently pursues the implementation of additional restructuring measures - based on a term-sheet agreed on by its shareholders and the Republic of Austria - combining OeVAG and more than 60 local Volksbanks into a single affiliated group according to Article 3 Directive 2006/48/EC by mid of 2012. On 26 April 2012, OeVAG's general meeting of shareholders decided on a number of milestones in this regard, resulting in a new ownership-structure retroactive as of 31 December 2011, where the local Volksbanks hold the majority of OeVAG and the Republic of Austria is the second largest shareholder.

After completion of these fundamental restructuring steps, OeVAG nevertheless will continue to streamline and restructure the group with the final target of becoming a lean central institution serving the local Volksbanks with a clear focus on the Austrian market.

Spain

In total, five Spanish institutions have gone or are undergoing significant integration processes which will result in their merger with other banks or their integration within other groups of credit institutions. Each of these processes is at a different stage and is being closely monitored by the Spanish authorities. The timeline for their completion depends on different resolutions and authorisations, and in some cases, it may fall outside the timeframe set by the EBA Recommendation:

- Caixa D'Estalvis de Catalunya, Tarragona i Manresa: In this case, Catalunya Bank, in which the FROB has a stake of 90%, has started the necessary steps for an integration process with another credit institution through a competitive procedure in accordance with Article 9.8 of Royal Decree-Law 9/2009, on bank restructuring and credit institutions equity reinforcement.

- Caixa D'Estalvis Unio de Caixes de Manlleu, Sabadell I Terrassa (Unnim): In the case of Unnim Banc, S.A. on 7 March 2012 the Government Committee of the FROB, which was its sole owner, drew up the restructuring plan for this bank, envisaging its integration within the Spanish bank BBVA.

- Grupo Caja 3: This bank announced on 29 February 2012 its merger with Ibercaja Banco.

- Caja de Ahorros del Mediterraneo (CAM): On 7 December 2011, the Government Committee of the FROB drew up restructuring plan for Banco CAM, which envisages that it will be integrated within Banco Sabadell.

- Banco Popular is finalising its takeover of Banco Pastor.

Greece

Two Greek banks, EFG Eurobank Ergasias and Agricultural Bank of Greece, have shown a capital shortfall in the stress test. These banks are undergoing deep restructuring as part of the pre-agreed measures under the EU/IMF programme.

Quantitative capital targets stemming from the latter exceed the results of the EBA EU-wide stress tests and EU Capital exercise. The implementation of EU/IMF measures and the fulfilment of capital targets are being closely followed by the respective national authorities together with the EU Commission, ECB and IMF.

Germany

In addition to the eight banks with identified capital shortfall, the EBA has followed up on one bank, which did not publish the EBA 2011 stress test results, namely Landesbank Hessen-Thuringen (Helaba) to understand the actions it has taken since the stress test. Helaba has "hardened" its participation capital in order to comply with the CT1 definition of the EBA. This conversion has led to an increase of CT1 capital by EUR 1.92bn.

Conclusions and further monitoring

The EBA is, in general, satisfied with the progress made in the fulfilment of the July 2011 Recommendation noting that the actions taken include capital strengthening and adequate recognition of losses. In addition, the EBA supports the measures undertaken to significantly restructure those banks in difficulty and sees this as an appropriate response to the Recommendation.

Generally, the EBA July 2011 Recommendation has been strengthened by the EBA December 2011 Recommendation. The 71 banks participating in the 2011 Capital exercise are being monitored by the EBA in order to check whether they adhere to the CT1 ratio of 9% by the end of June 2012.

Some Spanish banks subject to the July 2011 Recommendation are not represented in the sample for the December 2011 Capital exercise and therefore do not fall under the scope of the December 2011 Recommendation. Those banks remain under close scrutiny by their respective national supervisory authorities, and are also subject to the wide-ranging restructuring programmes undertaken under the aegis of the national measures put forward by the Spanish Government.

The EBA will continue to monitor and assess risks and vulnerabilities from a micro-prudential perspective in the EU banking sector employing a wide range of tools, including analyses of key risk indicators, bottom-up risk questionnaires to the supervisors of the largest cross-border banking groups, and joint risk assessments done by the colleges of supervisors. The EBA is currently developing its approach to the next EU-wide stress test exercise, which will take place in 2013.