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PRESS RELEASE

ECB MAKES PROGRESS WITH ASSET QUALITY REVIEW, AND CONFIRMS STRESS TEST PARAMETERS FOR COMPREHENSIVE ASSESSMENT

- Collection of first set of data completed, portfolio selection closes in mid-February
- Stress test will incorporate the results of the asset quality review
- As announced by the European Banking Authority, the capital thresholds for the baseline and adverse scenarios will be 8% and 5.5% Common Equity Tier 1 capital respectively

The European Central Bank (ECB) has today announced the progress made in its on-going comprehensive assessment. It also confirmed that it will apply the parameters for the stress test released by the European Banking Authority (EBA) on 31 January. Together with the asset quality review (AQR), the stress test forms part of the comprehensive assessment. The assessment aims to enhance the transparency of the balance sheets of significant banks and to rebuild investor confidence prior to the ECB taking over its supervisory tasks in November 2014.

Vítor Constâncio, Vice-President of the ECB, said: “Preparations for the stress test are well underway and we are confident that, in close coordination with the EBA, the outcome will be transparent and credible, boosting the European banking sector. We have noted that capital and provisioning measures have been taken since the exercise was announced. Banks are frontloading preparations for the comprehensive assessment, and are strengthening their balance sheets, which is a welcome development.”

Danièle Nouy, Chair of the Supervisory Board, said: “We will shortly finalise the portfolio selections, and will examine these on a risk-based supervisory assessment. The quality of the exercise and how it is undertaken are key elements to ensure that the loan books of the largest banks are valued correctly and are critical factors for the outcome of the exercise.”

The ECB is currently finalising the AQR methodology working together with national supervisors. The full methodology will be released in the course of the first quarter of 2014. The ECB will finalise the selection of portfolios for the AQR in mid-February. Afterwards, the national competent authorities (NCAs) and their third party specialists (auditors, consultants, asset evaluators) will review banks’ processes, policies and accounting practices, analyse their credit exposures and provisions, and evaluate their collateral and real estate assets. The general use of private sector firms is necessary not only because of the magnitude of the exercise but also to enhance its independence and credibility. The exercise will use a definition of non-performing exposures that has been agreed with the EBA, which means that every material exposure 90 days past due will be classified as non-performing even if not recognised as defaulted or impaired.

The comprehensive assessment will also revalue the most important level-3 securities (assets that are illiquid and difficult to value) whenever banks have material exposures in their banking or trading books. For banks with the most important trading books, it will also involve qualitative reviews of the core trading book processes and quantitative reviews of the derivative pricing models.

For the stress test element of the comprehensive assessment, as announced by the EBA, the capital threshold for the baseline scenario will be 8% Common Equity Tier 1 (CET1), whereas for the adverse scenario, a threshold of 5.5% CET1 will apply. Together with CET1 instruments, additional capital instruments that mandatorily convert to CET1 may be eligible to address a capital shortfall arising in the adverse scenario, as long as the conversion trigger is set at 5.5% or above. Only instruments with unconditional contract clauses relating to such conversion will be eligible.

Sovereign exposures in the held-to-maturity portfolios (HTM) will be treated in the same way as other credit exposures in that portfolio, i.e. the impact of the scenarios on the loss and default parameters will be calculated and will result in larger provisions. Meanwhile the same types of securities in the available-for-sale (AFS) and held-for-trading (HFT) portfolios will be marked-to-market, in line with the scenario employed. The effect of the gradual phasing-out of AFS prudential filters on sovereign exposures will be fully disclosed. In addition, bank holdings of sovereign exposures, and their respective maturities, will also be disclosed in full.

The ECB is committed to ensuring that the entire process is credible and that its quality is assured. For the AQR and the stress test, the ECB will be deploying its own teams to participate in and oversee local bank inspections. This includes participation in data consistency checks, conducting comparative analyses on the portfolio and thoroughly checking model inputs and assumptions. The ECB expects the scenarios for the stress test to be sent to the banks by the EBA at the end of April 2014.

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