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Results of the comprehensive assessment of the banking sector

- The comprehensive assessment of the European banking sector, the results of which have been published today, has satisfactorily fulfilled its main objectives: to improve transparency, to identify potential weaknesses on bank balance sheets and to contribute to strengthening banks' solvency.
- No Spanish bank currently has a capital shortfall and, generally, the margin by which they have exceeded the thresholds set in the exercise is a comfortable one.
- The exercise conducted (asset quality review and stress tests) shows that Spanish banks' balance sheets offer a rigorous view of their assets and that the impact of an adverse scenario on their solvency would be relatively limited.
- This outcome confirms that the clean-up, reform and restructuring of the Spanish banking system undertaken in recent years has borne fruit and that Spanish banks face the future with healthy balance sheets and a sound solvency position.

Objectives and phases of the exercise

The main aims of the comprehensive assessment are to increase transparency; to enhance the quality of information available on the position of banks; to strengthen bank balance sheets through the adoption of the necessary measures to redress the problems identified; and to improve confidence in the banking sector of the euro area countries.

The exercise comprised two phases: an Asset Quality Review (AQR) and stress tests.

The review, which was conducted following the methodology devised by the ECB, involved a detailed review of bank balance sheets. In this connection, in an initial stage, the bank portfolios to be analysed were selected, accounting for at least 50% of each bank's risk-weighted assets, giving priority to the highest-risk portfolios. Subsequently, an analysis was performed to determine whether the classification of financial instruments, provisioning levels and the valuation of specific assets was appropriate. This process, following a stringent quality assurance model in which the national authorities played a pivotal role, resulted in a series of adjustments to the level of CET1 (the maximum quality) capital, and these were taken into account to set the starting points for the stress tests.

The stress test is a forward-looking simulation exercise whose aim is to assess banks' resilience in two hypothetical macroeconomic scenarios: a baseline scenario based on the European Commission's forecasts, and a second, adverse scenario approved by the European Systemic Risk Board, which is severe but not implausible. The exercise enables the capital that might be needed in these scenarios to be estimated and identifies areas where other supervisory actions may be required.

The stress tests were performed by the banks themselves (the bottom-up approach) applying the methodology prepared by the European Banking Authority[1] (EBA), and they were also subject to strict quality assurance by the national authorities and the ECB.

The horizon for the exercise is three years (2014-2016), and the starting point was the consolidated balance sheets at year-end 2013.

Bearing in mind that the asset review and the stress test overlapped in time, an additional join-up exercise controlled in a centralised fashion by the ECB was carried out to integrate the results of both phases of the exercise. This ensured that the results of the asset review were taken sufficiently into account in the stress tests.

Recapitalisation of the capital shortfalls identified

Minimum thresholds were set in the exercise and had to be exceeded in the different phases of the comprehensive assessment. In particular, banks had to comply with a minimum CET1 ratio of 8% in order to come successfully through the AQR and the baseline scenario of the stress tests. In the adverse scenario of the stress tests, the minimum threshold was set at 5.5%.

The banks which have fallen short of these thresholds have two weeks to submit their capital plans, which must address how they will make good the shortfall identified within six months (if this shortfall arises from the asset review or from the baseline scenario of the stress test) or nine months (if it arises from the adverse scenario). In some cases, the action taken since January 2014 is sufficient to cover the shortfall and, consequently, it will not be necessary to take additional measures.

Scope of the exercise

The comprehensive assessment marks a major milestone on account of its scope, rigour and complexity. 130 institutions from 19 countries have participated in the exercise, accounting for 81.6% of the total assets of the banks that will be supervised by the SSM from 4 November. Of these banks, 15 are Spanish (representing more than 90% of the assets of Spanish deposit-taking institutions).

This is the first time that an exercise combining an evaluation of balance sheet quality and a stress test has been performed for the entire euro area. To make it possible, close coordination was needed between all the parties involved, including the ECB, national supervisory authorities, audit firms, consultancies, appraisers and the banks themselves. In terms of human resources, more than 6,000

[1] The stress tests were conducted in all EU countries. However, within the euro area, the complexity of the exercise is greater given that an exhaustive asset quality review (AQR) was also conducted, the results of which should be taken into account in the stress tests.

experts (more than 600 in Spain) took part.

The exercise covered the entire balance sheet of the participating banks, including their international business. Furthermore, the main risks (credit risk, market risk, etc.) were analysed.

Results of the comprehensive assessment

Aggregating the effects of the two phases of the exercise (asset review and stress test) for the set of banks analysed, its overall impact results in a reduction of the CET1 capital ratio of 3.4 percentage points (pp) with respect to the starting level. In Spain, the adjustment in relation to the starting capital ratio is 1.6 pp, considerably lower than the European average.

The asset-review impact in Spain is very limited and stands at 14 basis points (bp), below the European average (around 40 bp). Indeed, it is the Spanish banking system which has had fewer adjustments to make as a result of the review. These results show that the balance sheets of Spanish institutions adequately reflect the value of their assets, as a result of the rigorous review to which they have been subject in recent years, in tandem with substantial asset write-downs and the recapitalisation and restructuring of certain banks.

In the adverse scenario of the stress test, there is a reduction of 3 pp in the capital ratio in terms of the European average. In Spain this impact is much lower, at around 1.4 pp.

Considering these results, 25 European institutions have fallen short of one or more of the thresholds set and, consequently, according to the methodology, they had using end-year 2013 figures a capital shortfall of €24.6 billion.

However, it should be pointed out that many European banks adopted significant measures to strengthen their solvency between January and September 2014, thus anticipating the results of the exercise. In fact, the group of banks participating in the exercise increased their capital by approximately €40.5 billion in net terms in this period (the measures adopted by Spanish banks amounted to €3.7 billion). If these measures are taken into account, most of the capital shortfall has already been made good and, consequently, only 13 banks continue to have a capital shortfall as of today and, therefore, require additional action to be taken (for a volume of about €9.5 billion).

Only one Spanish bank, Liberbank, has fallen short of the threshold set in one of the phases of the exercise, although its capital shortfall is small (€32 million). Thanks to the capital strengthening measures by this bank in 2014, totalling approximately €640 million, this capital shortfall is more than covered.

The remaining Spanish banks have exceeded the thresholds set in the exercise by a substantially comfortable margin. Indeed, the capital ratio of all Spanish banks except one (Liberbank) is more than 2 pp above the 5.5% threshold set for the adverse scenario of the stress tests. Taking into account the measures taken in 2014, Liberbank would pass the test with a margin far higher than 2 pp.

The results suggest that, although the Spanish banking sector faces major challenges in the short and medium term (including convergence within a new regulatory and supervisory framework, and a complex economic environment that may affect their profitability), Spain's banks can look to the future from a positive vantage point, with healthy balance sheets and a sound solvency position.