

Update on the implementation of Capital Plans following the EBA's 2011 Recommendation on the creation of temporary capital buffers to restore market confidence

Executive summary

- 1. In December 2011, the EBA issued a Recommendation to national authorities that participating EU banks raise their Core Tier 1 ratio (CT1) to 9%, after accounting for an additional buffer against sovereign risk holdings.*
- 2. The EBA identified a shortfall for 27 banks of €76 bn¹, to be addressed by end-June 2012 via an increase of the capital elements of the highest quality and via a limited set of actions aimed at reducing risk weighted assets (RWAs), without impacting lending into the real economy. Comprehensive measures have subsequently been implemented by banks to comply with the Recommendation by end-June 2012. Relevant banks submitted their capital plans to National Supervisory Authorities (NSAs) in coordination with the EBA. These plans were discussed in supervisory colleges, where host supervisors had the opportunity to raise any concerns on those measures having an impact on their own jurisdictions and credit markets.*
- 3. According to the updates of the plans submitted in June, banks are generally on track to comply with the EBA Recommendation and the measures initially identified have been implemented as planned. According to the latest updates, the exercise will result in an aggregate €94.4 bn recapitalisation for the 27 banks and in a significant restructuring for the remaining 4 banks. Compliance with the Recommendation has been achieved mainly via new capital measures (retained earnings, new equity, and liability management), and to a lesser extent, by releasing capital through measures impacting RWAs.*

¹ *Of the 71 EEA banks in the capital exercise, thirty seven banks showed an initial shortfall of €115 bn. However, three banks (Dexia, €6.3 bn; Volksbank AG, €1.1bn; West LB €0.2bn) were identified as being involved in such deep restructuring that submission of plans was unnecessary. Similarly, the initial shortfall for six Greek banks (€30 bn) would be addressed in the Greek Programme, therefore no separate plans were requested. Finally, Bankia (€1.3bn), which initially submitted a capital plan, has subsequently gone into an intensive restructuring in early May 2012 and will therefore be monitored separately by the relevant authorities. The initial shortfall for the remaining 27 banks is €76 bn.*

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4. *The recapitalisation exercise was a necessary step on the road to repairing EU banks' balance sheets. It is one of a series of coordinated policy measures agreed by the European Council last October. Although the external environment remains very challenging, the recapitalisation has contributed to strengthening the capital base of the banking system and put banks in a stronger position to continue lending to the real economy. Along with the ensuing ECB long-term refinancing operations, which alleviated the liquidity tail risk of EU banks, these are necessary steps to gradually restoring access to market funding.*

 5. *The process of balance sheet repair is, however, on-going. Following the recapitalisation exercise, NSAs will continue their heightened supervisory monitoring. Where necessary, they will undertake detailed reviews of each bank's asset quality – both assessing the loss contents of loan bank-books and revaluing asset collateral on a conservative basis.*

Background

1. In July 2011, the EBA's EU-wide stress test attempted to assess the impact of credit losses and of elevated funding costs on banks' balance sheets. The stress test prompted significant pre-emptive capital-raising action by banks (€50bn for the first four months of 2011) was accompanied by an unprecedented transparency exercise, which addressed longstanding uncertainty about bank holdings of various asset classes, including government debt. The EBA subsequently recommended capital strengthening for banks with CT1 below 5% and for those above 5% but holding significant amounts of stressed sovereign debt.
2. As the EU financially-stressed sovereigns' situation in the market deteriorated in 2011, the EBA advised on the need to break the link between banks and sovereigns via (i) direct capital injections into banks from EU bodies, (ii) effective EU-wide bank term debt guarantees, and (iii) higher capital buffers across the entire banking system.
3. In this context, in December 2011, the EBA issued a Recommendation that all participating EU banks raise their CT1 capital to 9% after accounting for an additional buffer against stressed sovereign risk holdings. This Recommendation was aimed at reassuring the market that the EU banking system as a whole had the ability to withstand a range of credit shocks – including sovereign stresses – and still maintain adequate capital. This requirement for a capital buffer was not the result of a stress test and was not based on an actual asset quality review of each bank.
4. A sample of 71 EEA banks took part in the capital exercise, of which 31 banks, excluding Greek banks, experienced an initial shortfall in meeting a 9% CT1 ratio after including the sovereign buffer. 28 banks out of the 31 provided capital plans to comply with the EBA December Recommendation. The remaining three banks are currently involved in deep restructuring, with a wind-down of their activity: Dexia, Österreichische Volksbank AG and WestLB AG, Düsseldorf. Bankia, which initially submitted a capital plan, is now undergoing fundamental restructuring and will be monitored separately by relevant authorities. (See para 29). Therefore, the current report covers the remaining 27 banks, with a shortfall of €76 bn.

The capital exercise is a one off exercise conducted with the aim to restore market confidence in the banking sector. It is not a stress test exercise. No assessment of assets quality was undertaken

5. NSAs submitted the banks' capital plans to the EBA at the end of January 2012, in line with the EBA December Recommendation (EBA/REC/2011/1). Following this submission, discussions on the measures designed by banks took place in the framework of colleges, allowing an exchange of views among home and host supervisors.
6. Discussions in supervisory colleges provided the opportunity for all relevant competent authorities 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. Host supervisors had the opportunity to raise any concerns during these meetings. For those banks with no college

in place, plans were discussed bilaterally between the EBA and the NSA, in order to clarify the eligibility, feasibility and timeline of planned measures, and their possible impact on the real economy.

7. Notwithstanding the fact that formal approval of plans and communication with banks is a matter for Consolidating National Supervisors, the EBA, together with NSAs has been monitoring the progress in the implementation of plans by banks. This report is based on the updates on the progress in the implementation of capital plans submitted by 27 banks.
8. This report is preliminary. The final assessment of the capital exercise and compliance of the sample of 71 banks involved in the exercise will be based upon an extensive collection of data - similar to the one undertaken as of September 2011 - provided by banks from their 30 June financial statements. The EBA assessment will be undertaken during the summer and the final report for all banks will be published in September.

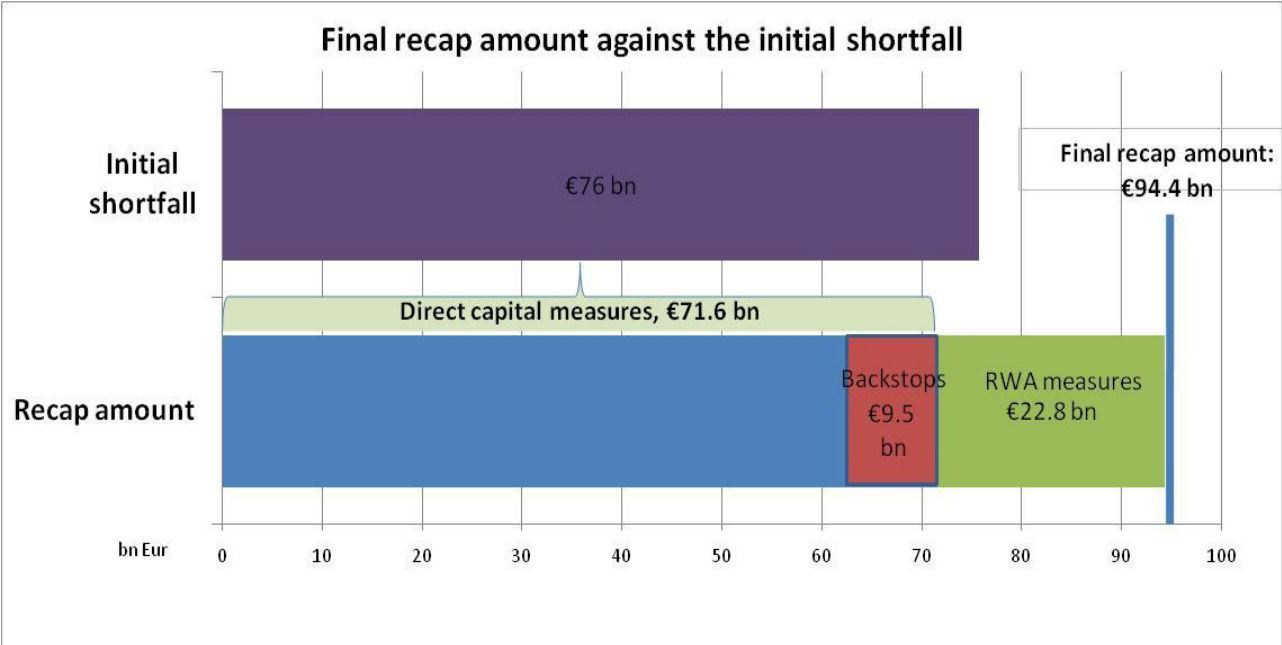
Progress on the implementation of the capital plans – Overview

Banks are on track to comply with the EBA Recommendation

- 9. As of 30 June 2012, the 27 banks with a shortfall of €76 bn, resulting from the 2011 capital exercise, reported that they have reached a recapitalisation amount² of €94.4 bn.
- 10. The 27 banks are on track to comply with the EBA Recommendation as at end June, Seven of these banks are relying on government backstop measures to reach the 9% level³. In the case of one bank, reporting its capital position above the 9% level as at end June, the final validation of the implemented measures is subject to the formal endorsement by the EU Commission under state-aid rules.

Capital measures predominate over RWA measures - Banks have strengthened their capital position mainly increasing eligible own funds, and to a less extent, releasing capital through measures impacting the RWA

- 11. The increase in eligible own funds through the implementation of capital measures represents 76% of the total recap amount while the release of capital through the execution of RWA measures amounting to 24%.



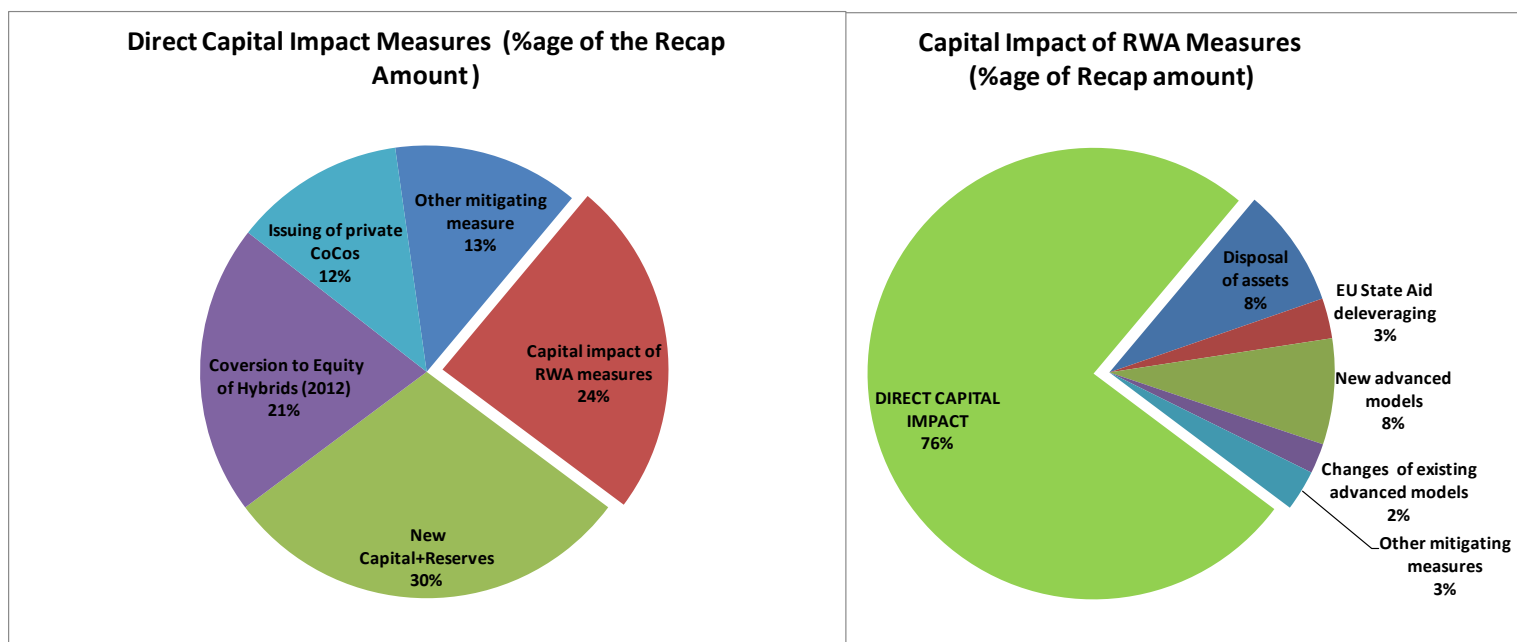
² The recapitalisation amount stands for the additional amount of capital reached as a result of the capital plans through the implementation of capital measures plus the amount of capital released through the implementation of RWA measures.

³ Backstops have already been implemented in the case of four banks; for the other three banks they are in the process of being finalised.

12. Backstop measures mainly consist of new issuances of capital instruments. These instruments will, in most of the cases, be underwritten by governments directly or through the support of the European Financial Stability Facility (EFSF).

Measures taken – Breakdown

13. The charts below show the breakdown of the recapitalisation amount as at 30 June 2012, distinguishing between measures which directly enhanced capital and those affecting RWAs.



The 27 banks have broadly strengthened their capital positions with new ordinary capital and reserves, and have raised own funds by 12% since September 2011

Direct capital measures

14. Since September 2011, and as result of their capital plans, the 27 banks have increased their core capital position (ordinary equity plus reserves) by €41 bn through the issuance of new ordinary shares, the payment of dividends in shares, retained earnings and conversion of hybrids into common capital. As of 31 October, ordinary capital will have increased by an additional €6.4 bn, taking into account the scheduled conversion into shares of hybrid instruments. Therefore, by 31 October 2012, the 27 banks will have increased their core capital by €47.4 bn, a 12% increase compared to September 2011⁴.

⁴ This is 51% of the total recapitalisation amount (€94.4 bn) and 62% of the initial shortfall of €76 bn for the 27 banks.

15. Furthermore, banks have issued a number of Buffer Convertible Capital Securities compliant with the EBA Common Term Sheet. The total issued is €11.5 bn⁵. These bonds are not CT1 instruments but are eligible to meet the EBA Recommendation. With these new instruments, banks have strengthened their capital position by a further 2.9% compared to September 2011.

16. Finally, other mitigating measures directly impacting banks' capital position amount to €12.6 bn⁶. These impacts stem from:

- Lower deductions from CT1 capital (depreciation/disposal of goodwill and intangible assets, disposal of securitisation portfolios, reduction in the difference between expected losses and specific provisions in case of IRB models, disposal of non consolidated subsidiaries/stakes on financial firms);
- Consolidation impacts on capital (e.g., increase on minority interests)
- Further impairments on sovereign exposures accounted after September 2011⁷.

Release of capital stemming from RWA reductions

In line with the Recommendation, capital plans have not led directly to a significant reduction of lending into the real economy. A deleveraging process had already started before the capital exercise and will need to continue in an orderly fashion.

17. Measures related to a decrease in lending led to a reduction of just 0.62% of total RWAs at September 2011⁸ (reduction in RWAs of €30.3 bn). Moreover, this deleveraging was focused on a small number of banks that are in specific agreements with international and EU organisations in the framework of formal restructuring plans and state aid injections.

18. Disposals of assets had a positive impact on capital of €8.1 bn, and led to a RWA reduction of €90 bn, or 1.8% of RWAs at September 2011. This was also focused on a small number of banks and the disposals concentrated mainly on non-core assets, especially US dollar denominated assets held outside the EU, in relation to the disappearance of US dollar funding in the last part of 2011.

19. Both the measures related to deleveraging, and the disposal of assets, were broadly discussed in the framework of colleges, where host supervisors had the opportunity to raise any concerns on those measures having an impact on their own jurisdictions.

⁵ 12% of the recap amount and 15% of the initial shortfall.

⁶ 13% of the recap amount and 16% of the initial shortfall.

⁷ In order to avoid double counting of losses stemming from further impairments of sovereign exposures through provisions accounted after September 2011 and the sovereign buffer calculated as of 30 September 2011, it was agreed that these write downs of sovereign exposures should be included as additional mitigating measures within the limit of the country component of the sovereign buffer.

⁸ RWA as at Sept 2011: €4,922 bn.

20. As stated on the EBA Recommendation, reductions in RWAs due to the validation, roll-out and changes of internal models were only allowed as a means of addressing the capital shortfall in those cases where changes had already been planned and were under consideration by the competent authority.

21. Finally, other mitigating measures have reduced the RWAs by €30.6 bn, 0.62% of RWAs at end September 2011. These measures consist mainly of: improvement in collaterals and guarantees and impacts stemming from the application of CRD 3⁹.

In those cases where Governments have committed to supporting banks to meet the EBA Recommendation, adherence to some common principles has been ensured

22. Government commitments to provide public backstops to those banks that would otherwise not comply with the Recommendation had to meet common principles. A written statement, detailing the amount committed and drawing a clear timeline within 2012, was requested in order to show the government's willingness to underwrite the new issuance. According to the principles, the EBA should be allowed to publicly refer to this timeline in its September report on the Recommendation. In addition, the Consolidating National Supervisor agreed to keep the EBA informed of the progress made on an ongoing basis and to immediately notify the EBA of any change or contingency in this respect.

Activation of public backstops

Public backstop contributed to an injection of fresh capital by 9.5 bn.

23. By the end of June, the recapitalisation operations of three Portuguese banking groups were concluded after the publication, on 17 May 2012, of the Portuguese Ministry of Finance Ordinance ("Portaria n.º 150-A/2012") in which the conditions of the instruments to be subscribed by the Portuguese State were established: Caixa Geral de Depósitos (€1.65 bn), Banco Comercial Português SA (€3 bn) and Banco BPI SA (€1.5 bn). On 29 June, the financial instruments were subscribed by the Portuguese State and the capital injections were settled at that time into those banking groups. With these capital increases, the aforementioned banking groups have complied with the EBA Recommendation and the Core Tier 1 capital requirements.

24. The Slovenian Nova Ljubljanska Banka d.d. has reached the 9% level thanks to government support, after an issuance of contingent convertible instruments underwritten and fully paid by the Republic of Slovenia by the end of June, amounting to €0.32 bn.

25. With regard to Banca Monte dei Paschi di Siena, on 27 June the Italian Government approved the Decree-Law n. 87/2012 establishing a form of Government support in order to cover the

⁹ More accurate estimations on the impact on RWA of the implementation of CRD3 have led in some cases to downward adjustments on the RWA figures.

residual shortfall of MPS according to the decisions of the European Council of 26th October 2011. The support will take the form of capitalisation instruments up to an amount of €2 bn.

26. The two Cypriot banks taking part in the capital exercise, Bank of Cyprus and Cyprus Popular, have not been able to reach the 9% core tier target by actions in the private market. Nevertheless, the EBA has received reassurance that these banks will comply with the EBA Recommendation as a result of the government's decision to request the support of the EFSF. It is possible that additional capital needs for these two banks will be required after assessment by the relevant EU authorities and the IMF in the framework of the assistance programme.

Other cases

27. Nova KBM d.d., another Slovenian bank, which was above the 9% target as of end of September 2011, has subsequently shown a shortfall mainly due to the recognition of further credit risk impairments. Therefore, the bank has submitted a detailed capital plan to the EBA in order to meet the 9% target. The capital plan expects to meet the Recommendation by September 2012 through private investors. However, backstops are in place, with an ultimate and eventual recapitalisation by the Republic of Slovenia, if necessary, with a deadline of 31 December 2012.
28. Concerning Norddeutsche Landesbank –GZ, the German Bank has achieved the 9% CT1 as of end of June after the implementation of its capital plan. The final validation of the implemented measures is, however, subject to the final formal endorsement by the EU Commission of the ongoing state-aid investigation. As of the end of June, it appears this agreement is on track for a final decision to be taken imminently.
29. Finally, for Bankia, which initially submitted a capital plan, a restructuring process is under way, now within the context of the Spanish Authorities' request for financial support from the EFSF. Banco de España, in conjunction with the EU Commission, liaising with the ECB, the EBA and the IMF, is currently carrying out a comprehensive asset quality review on a number of Spanish banks, including some other banks participating in the capital exercise, where their final capital needs are being assessed. The EBA is involved in this process in compliance with EFSF guidelines.