Vítor Constâncio: Comprehensive assessment press conference – introductory statement

Introductory statement by Mr Vítor Constâncio, Vice-President of the European Central Bank, Frankfurt am Main, 26 October 2014.

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Accompanying slides can be found on the European central Banks' website: http://www.ecb.europa.eu/ssm/assessment/shared/pdf/141026_presentation-slides.pdf

Welcome to this press conference about the results of the comprehensive assessment. And at the start, let me make four points. The first one is to underline that the comprehensive assessment has unique features. Namely, it combines an asset quality review with a macro stress test, which indeed is a very unique feature. Second, it disclosed a very detailed methodology, called manuals, for both components of the exercise and for the respective quality control of banks' reporting.

Third, the implementation of the exercise involved many thousands of experts, including about 5,000 independent private firms. More than 800 individual portfolios were in the scope of the exercise, representing almost 60% of total risk-weighted assets of the banks and implying the analysis of credit of 119,000 borrowers of the banks.

And fourth, the exercise provides, with unprecedented transparency, a vast array of data from banks' balance sheets and from the final results. The massive nature of the exercise deserves to be acknowledged. And its results are credible, because they stem from an accurate methodology, from a rigorous implementation and from a demanding central quality control of the results.

The second point I wanted to make is that the conclusion of the exercise was preceded by a significant amount of front-loaded measures taken by the banks. Since July last year SSM banks have undertaken various measures to strengthen their balance sheets by more than €200 billion, including €60 billion of capital increases. These front-loaded measures are part of the overall successful outcome of the exercise. Some of the measures taken in 2013 had an impact on what could be detected by the exercise, and so reduced the results of the exercise accordingly. And some of the measures taken in 2014 count for the mitigation of the capital shortfalls that were found.

Third point, the comprehensive assessment provides the ECB SSM with substantial information on the banks that will fall under its direct supervision and will help its efforts in creating a level playing field for supervision in the future.

And fourth, the repairing of the banks' balance sheets that will follow the results, and the resilience revealed by the vast majority of the banks in spite of the severity of the exercise, guarantee that the economic recovery will not be hampered by credit supply restrictions coming from the banking sector, provided that there is enough aggregate demand.

I will now go through the slides. Let me underline the main results of the exercise. A total of €25 billion capital shortfalls were identified across 25 participating banks as a joint result of the AQR and the stress test. The AQR itself resulted in a gross impact on asset values in need of adjustment by €48 billion, €37 billion of which did not generate a capital shortfall. So if you add up the €37 billion with the €25 billion shortfall, you get the overall impact on the banks of €62 billion coming from the comprehensive assessment.

This you can compare with the expectations in the market. I just quote two examples of publications by investment houses of September, the more recent ones, of two big investment banks. One made calculations for a sample of 37 banks and found that, considering the measures already taken by the banks, the shortfall would be zero, and three banks would fail. The other one considered a sample of 34 banks and concluded that, taking

into account the capital measures taken by the banks in 2014, zero banks would fail and the capital shortfall would be zero. This compares with our result that out of the 25, 12 banks have already taken measures in 2014 that are enough to cover their shortfall. But there are then 13 banks that still have either to exactly apply their restructuring downsizing as it is foreseen in their plans with the European Commission, or they will have to come up with ways to increase their capital. So this is an important explanation of the meaning of the results that we have.

Within the context of the exercise of the asset quality review the non-performing exposures of the banks were increased by €136 billion, out of which come, of course, the €48 billion that have to be adjusted.

Another measure of the strictness of the exercise is given by the fact that the combination of the AQR with the stress test results in a drop in the median capital ratio of the banks of 4 percentage points, which is higher than in previous exercises. And in terms of billions, this means that the exercise leads to a decrease of €263 billion overall for all the banks, out of which €25 billion corresponds to the capital shortfall, meaning the banks that came below the threshold of 5.5%.

But this is a measure of the strictness of the exercise that it had such an impact on the balance sheet of the banks, and it's a usual measure of the impact of such types of exercises. But it's also a measure of the resilience of the system because, in spite of this drop of €263 billion, the vast majority of banks stayed above 5.5% and were able to support such a shock, and still have a capital ratio above the threshold.

And let me underline that the threshold of 5.5% is well above the regulatory minimum, because as you know the regulatory minimum for common equity capital ratio will be in 2018 4.5%, so we have chosen a more demanding threshold. And most of the banks were able to resist such a drop in their capital and stay above the threshold. That's proof of the resilience of the system, and at the same time proof of the strictness of the exercise.

The distribution of this drop in the capital ratio you have in this slide. I'm not going to comment in detail. Just to underline that 75% of the participating banks experienced a 0 to 6 percentage points impact on Common Equity Tier 1 under the adverse scenario.

Now the capital shortfall itself, as I said, comes both from the AQR and from the stress test. And the distribution you have in this slide, 11.2% from the stress test and 10.7% from the AQR. This is the capital shortfall from the stress test, 11.2%, but in the previous slide you have seen that the drop in capital coming from the stress test corresponded to €182 billion, which is a component of the €263 billion that I highlighted just now. So this is then the composition.

And what I said about the front-loading that the banks have done since July last year is disaggregated in this table. And you see that the overall amount of measures of different kinds, they are not just capital measures, but are measures that strengthen the balance sheet and help to clean and prepare the balance sheet for the exercise. Gross equity issuances since then amount to €60 billion. CoCos or contingent capital issuance instruments that count as additional Tier 1 and satisfy our conditions amounted to another €32 billion.

Internal capital generation, either by retained earnings or by extra provisions, and we calculated the provisions that are above what would have been the normal trend of evolution of provisions because indeed, as you well know, since last year banks have been increasing provisions just preparing for the exercise and the two things together amount to €44 billion. And then the other measures, asset sales and others, amount to €67 billion. This is a measure of the front-loading by the banks in preparing for the exercise, which is important to highlight because capital increases or increases in extra provisions done last year indeed reduced the numbers that the exercise could detect in the end.

The stress test itself, it's also important to highlight that the severity of the scenario in the adverse case was indeed higher than in previous exercises. In fact, if we compare with previous exercises, taking the metric of the GDP drop in the adverse scenario, after two years in this present exercise the GDP on average would drop by 5.1%, whereas in previous exercises it dropped by 3% or 4% only. And this exercise had a third year which was not present in the previous exercises, so that the overall drop in GDP in the adverse scenario over the three years comes to 6.6%. So indeed the whole stress test was more severe also because of other shocks that were considered in the adverse scenario.

Just as an example, in what regards the shock in interest rates that the exercise assumes, we had an increase of the yields of sovereign bonds, which in the first year on average was 152, and the second year another 112, and in the third year also 112.

You have then the distribution by country in this slide, and what is above the zero is the shock that we imposed in the scenario, an aggravation of the yields of sovereign bonds. And then below zero you have what happened since last year. And what happened? It was, as you know, exactly the opposite that the yields dropped a lot and so the prices of sovereign bonds increased on average by 12%. So this is just another indication of the severity of the exercise in confrontation with what has happened in reality since last year.

Finally just to give you an idea about the drivers that command the impact of the stress test itself alone, of course the first three rows in this table show the increase in revenues, which is normal during the three years, and then the costs that were affecting the profit and loss accounts of the banks, and finally the impact on capital. And you have then there, for instance, the shocks admitted on sovereign bonds imply a loss of €28 billion for the banks in the exercise that administrative costs and other expenses imply a drop in profits and in capital of €865 billion. And that loan losses coming from the assumptions of the stress test on the probabilities of default and the loss given default of the credit portfolio of the banks imply a loss of €378 billion.

And that's how you reach €181 billion. And the difference with €182 billion that I showed before is just a matter of approximation – it's the same figure. And this is the disaggregation of the figure. So this really shows that the exercise was indeed quite strict. It was implemented by officials and private experts. And the results, as I said, guarantee that going forward the economic recovery will not be hampered by credit supply restrictions.