1 INTRODUCTION
The comprehensive assessment of banks in the euro area has reached an advanced stage, as the major work blocks of the asset quality review (AQR) are being completed in August. The methodology for the “join-up” of the AQR and the stress test is currently being finalised by the European Central Bank (ECB) and will be published in the first half of August. Today the ECB has released the templates which will be used to disclose the bank-level results of the comprehensive assessment. Upon publication of the results in the second half of October 2014, banks facing a capital shortfall will be requested to submit capital plans within a period of two weeks, which will then be evaluated by the Single Supervisory Mechanism (SSM). The ECB-led SSM Joint Supervisory Teams (JSTs) will closely track the implementation of these plans as of 4 November 2014.

2 STRESS TEST AS PART OF THE COMPREHENSIVE ASSESSMENT
Banks have submitted preliminary bottom-up stress test results to the ECB, the national competent authorities (NCAs) and the European Banking Authority (EBA), in accordance with the EBA methodology, prescribed stress test scenarios and additional ECB guidance. The quality assurance process of the banks’ bottom-up stress test results has started and will continue until early September. Thereafter, the AQR findings and the stress test results will be joined-up. Only then can the full results of the comprehensive assessment be determined. A key strength of the exercise is that the results of the AQR will be used to adjust the starting-point balance sheet of the banks for use in the stress test, thereby enhancing the robustness and consistency across banks of the projected results produced over the stress test horizon.

The join-up approach is a hybrid one in that the join-up will partly be performed by the banks, and partly by a centrally led team of NCA and ECB experts. All of the findings of the AQR will be included in the stress test. First, for all portfolios that have been subject to the AQR, the year-end 2013 starting balance sheet for the stress test will be adjusted to
include all the AQR findings. In addition, wherever the findings for portfolios covered in the AQR show material differences with the banks’ own figures, parameters to forecast total losses in the stress test will be adjusted so as to reflect those differences. Further details on the approach will be provided in a note on the join-up methodology that is scheduled for publication in the first half of August.

3 DISCLOSURE OF THE COMPREHENSIVE ASSESSMENT RESULTS

Public disclosure of the comprehensive assessment results will be based on standardised templates that show the results for each individual bank. These templates will be used in late October to present the bank-by-bank outcome. In addition, an aggregated report will be published, providing a broader perspective on the outcome of the exercise across the full sample of banks, as well as aggregate analyses of specific issues and methodological explanations.

The ECB has published the bank-level disclosure template today, after having consulted all participating banks so as to give them an opportunity to provide comments and suggestions. The template comprises the following main sections:

a Main results and overview;

b Detailed AQR results; and

c Detailed stress test results (identical to the EBA’s disclosure template).

Main results and overview

The spreadsheet entitled “Main results and overview” provides a summary of the comprehensive assessment results for the respective bank. As a starting point, key metrics as at 31 December 2013 are displayed in order to illustrate the bank’s position before the start of the exercise. In addition to the Common Equity Tier 1 (CET1) ratio based on 1 January 2014 rules, as defined in the Capital Requirements Directive IV/Capital

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1 The ECB will publish solely the English template, but the NCAs may publish the figures in a template using their respective national language.

2 The ECB will publish this report in English, but the NCAs may publish versions in the respective national language.

3 This section is not included in the template published by the ECB today.
Requirements Regulation (CRD IV/CRR), both the Tier 1 capital ratio, as defined in the Capital Requirements Directive III (CRD III), and the Core Tier 1 capital ratio, as defined by the European Banking Authority (EBA), are shown.\textsuperscript{4} The differences between CET1 ratio and the Tier 1/Core Tier 1 capital ratios reflect the implications of the entry into force of the CRD IV/CRR and the revised definitions of regulatory capital ratios for banks’ capital positions, thus allowing them to be distinguished from the impact of the comprehensive assessment.

The overall impact of the exercise on the bank’s CET1 ratio is shown separately for each of its key components, disclosing the CET1 adjustment based on the AQR, as well as the adjustments based on the baseline scenario and the adverse scenario of the stress test. The results of the stress test include the effects of the AQR via the join-up methodology.

Finally, the spreadsheet also includes an overview of major capital measures that have been taken by banks between 1 January and 30 September 2014. This information provides an indication of those changes in the bank’s capital position over this period that are not reflected in the calculation of the potential capital shortfall, as at 31 December 2013, identified in the comprehensive assessment, but that have direct implications for its coverage. It should be noted that the items disclosed in this section are limited to capital market activities. As such, they do not represent the full range of factors with a potential impact on the regulatory capital ratios, which will be addressed in the capital plans to be drawn up by banks with a capital shortfall. In addition, material incurred fines and litigation costs are disclosed.

The items disclosed include:

- issuance of capital instruments eligible as CET1 capital;
- repayments of CET1 capital and buybacks;
- the conversion of hybrid instruments into CET1 capital;
- net issuance of additional Tier 1 instruments;
- material incurred fines/litigation costs (net of provisions) from January to September 2014.

\textsuperscript{4} The Core Tier 1 ratio is shown only for those banks which participated in the 2011 EBA stress test, since other institutions were not required to report it. The figure shown will reflect the reference date 31 December 2013.
**Detailed AQR results**

The spreadsheet entitled “Detailed AQR results” provides specific insights into the different findings of the AQR that are reflected in the overall CET1 adjustment. The adjustments shown are split into those resulting from the work blocks dedicated to assets accounted for on an accrual basis and those resulting from the fair value review in line with the AQR manual.

The AQR adjustments to assets accounted for on an accruals basis are based on an examination of specific portfolios that were selected through a risk-based approach in Phase 1 of the exercise. The portfolios examined cover at least 50% of each bank's credit risk-weighted assets (RWA). Indications on the percentage of portfolios selected for examination (in terms of RWA) are provided by asset class and displayed on the basis of quantitative buckets of 20%. The risk-based approach to portfolio selection was designed to identify those portfolios with the highest risk of misclassification, risk of misvaluation, or inadequate provisioning level. Therefore, it is crucial to note that extrapolation of results to the non-selected portfolios would be highly incorrect from a statistical perspective.

The AQR adjustments to the selected portfolios (net of any offsetting impact of tax effects or risk protection schemes) are disclosed broken down by asset class, differentiating between adjustments under different AQR work blocks:

- adjustments to provisions on sample files;
- adjustments due to the projection of findings; and
- adjustments to provisions due to the collective provisioning review.

The disclosure of the adjustments based on the fair value review follows similar lines, providing information on the portfolio selection and splitting the adjustments into the specific work blocks on which they have been based:

- fair value review;
- non-derivative exposures review;

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5 For example: A bank holds corporate exposures totalling credit RWA of €1 billion. Of that total, exposures amounting to €500 million have been subject to examination in the AQR, according to the risk-based portfolio selection. The entry in the column “portfolios selected in Phase 1” for the row “Corporates” will read “40%-60%”. 

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• impact of the Level 3 derivatives pricing model review;

• increase in level 3 exposures following the processes, policies and accounting (PP&A) review.

The detailed disclosure of AQR results also features a matrix breakdown of two key asset quality indicators, namely the ratio of non-performing exposures (NPEs) and the coverage ratio, both based on the simplified EBA definition of NPEs, applied consistently throughout the comprehensive assessment. While the application of this definition constitutes a very important leap forward in terms of harmonisation across the euro area banking sector, the degree of harmonisation reached is not completely perfect due to factors such as different materiality thresholds across Member States. However, a solid basis of consistency has been implemented for the comprehensive assessment, implying a very significant improvement in comparability across banks from different jurisdictions. For both indicators, a breakdown by asset class is shown, disclosing their unadjusted level as at 31 December 2013, as well as the level after AQR adjustments, with the changes illustrating the impact of the AQR.

Finally, the bank-level disclosure template also includes the starting point leverage ratio and the impact of the AQR adjustments. This is a memo item disclosed for information purposes only. The leverage ratio is currently not binding and has no impact on the capital shortfalls identified in the comprehensive assessment. The figures shown are based on the definition of the leverage ratio provided in Article 429 of the CRR that is applicable as of January 2014.

**Detailed stress test results (based on EBA templates)**

The detailed results of the stress test component of the comprehensive assessment are disclosed in the form of the template developed by the EBA for all banks participating in the EU-wide stress test. As noted, the stress test results published for SSM banks will incorporate adjustments based on the AQR.

4 COMMUNICATION PROCESS

The results of the comprehensive assessment will be disclosed to the public in the second half of October after a final decision by the ECB.

More precisely, the process envisages the following milestones:
• Over the next few months until the publication of the comprehensive assessment results in October, interaction between supervisors and banks will intensify further in order to check the facts and to validate specific findings of different work blocks of the assessment. This interaction is part of the normal supervisory process. Any findings communicated to the banks in the course of this process will be partial and preliminary in nature and, as such, not to be disclosed by banks.

• In September, the join-up of the AQR and the stress test will take place.

• In September/October, a review of partial and preliminary AQR and stress test results (including elements regarding the join-up of both components) will be conducted with the banks. These meetings will be organised under the auspices of the ECB and will allow discussions that are essential for attaining a common understanding of banks and supervisors on the key elements and the main individual drivers of the outcome of the exercise, while not addressing the full final impact on banks’ capital ratios. It is important to note that no bank will be given certainty concerning the full overall result on this occasion.

• Prior to publication, the comprehensive assessment results will be endorsed by the ECB. Banks will be informed of the comprehensive assessment results very close to the time of public disclosure in order to avoid an untimely and disorderly publication of the results.

• In November, banks will submit their capital plans to the ECB, which will subsequently be assessed by the JSTs (see next section) for review by the Supervisory Board.

5 PREPARATION AND IMPLEMENTATION OF CAPITAL PLANS
The ECB will request all banks that face a capital shortfall on the basis of the results of the comprehensive assessment to submit capital plans within two weeks after the public disclosure of the results, detailing how the shortfalls will be covered within the foreseen time frame. The ECB-led JSTs will be responsible for assessing the capital plans submitted by the banks and for monitoring their implementation. As communicated earlier, banks will be expected to cover shortfalls arising from the AQR, or the baseline
Eligibility of capital measures

The submission of capital plans will be based on a specific template developed by the ECB. It will account for items with a positive or negative impact on the CET1 ratio that do not change the disclosed shortfall of a bank, but are relevant with respect to its mitigation.

As a general expectation, shortfalls revealed by the AQR and the baseline stress test scenario should be covered mainly by new issuance of CET1 capital instruments. The use of additional Tier 1 capital instruments to cover shortfalls arising from the adverse stress test scenario will be limited, depending on the trigger point of conversion or write-down, as outlined in the ECB’s press release of 29 April 2014. As was described in the last public communication, there will be no limits on the eligibility of existing convertible instruments that are subject to an unconditional pre-defined conversion into CET1 within the stress test horizon, nor on existing state aid instruments used by Member States in the context of financial assistance programmes.

Asset sales and their impact on the profit and loss, RWA and deductions from CET1 are eligible as exceptional measures only where they can be clearly identified as being distinct from normal business operations. Typically, large asset sale programmes for clearly separated portfolios (e.g. disposals of securitisation portfolios) and sales of subsidiaries will fall into this category. The impact of formal deleveraging or restructuring plans (agreed with the European Commission) will be taken into account. Reductions of risk weighted assets due to Pillar 1 risk model changes and switches in Pillar 1 approaches will not be deemed eligible for addressing a capital shortfall, unless these changes were already planned and approved by the competent authority before the disclosure of the comprehensive assessment results.

In their capital plans, banks will be able to propose that shortfalls arising solely from the AQR may be offset by retained earnings from 2014. With respect to capital shortfalls arising either under the baseline or under the adverse scenario of the stress test, only the difference between the realised pre-provision profits from 2014 and the pre-provision...
profits predicted for the same year in the stress test scenarios is eligible as a mitigating measure. This is due to the fact that accounting for the full amount would imply double counting since earnings are already taken into account in the bank’s projections for the stress test.

As outlined in the Terms of Reference on shortfalls and burden-sharing following the comprehensive assessment published by the ECOFIN and the Eurogroup on 9 July, the first port of call to address capital shortfalls is private sources. Nevertheless, as also mentioned in the aforementioned Terms of Reference, public recapitalisations may be required in certain situations, but this should be the exception rather than the rule, and should be used only when strictly necessary to remedy a serious disturbance in the economy of a Member State and to preserve financial stability. From January 2015, the use of public funds would imply that an institution is deemed to be failing, or likely to fail, and would lead to resolution, except for precautionary public recapitalisations that meet all the conditions of the Bank Recovery and Resolution Directive (BRRD). These precautionary recapitalisations will not trigger resolution, and will be conditional on final approval under state aid rules, including the presentation of a restructuring plan and burden-sharing, thus ensuring a level playing field.

In accordance with the November ECOFIN statement, all Member States will ensure that the necessary tools are in place, including changes to national legislation, as appropriate, enabling them to proceed with required burden-sharing under state aid rules and the BRRD as soon as possible.

**Monitoring of implementation**

As mentioned, the JSTs will assess all planned capital measures in terms of their feasibility, viability and credibility. If a capital plan is found not to be adequate or credible, the ECB will decide on possible supervisory measures according to Article 16 of the SSM Regulation. Those measures will be implemented as part of the decisions taken under the annual Supervisory Review and Evaluation Process for 2014, which will be based on the results of the comprehensive assessment, the assessment of the capital plans and the outcome of the annual review and evaluation conducted by NCAs. After the submission of this decision to the banks, scheduled for December 2014, the JSTs will start to monitor the implementation of the capital plans by way of a continuous dialogue with the banks, involving existing colleges of supervisors wherever appropriate.
As part of this monitoring process, the JSTs will closely track the incorporation, in line with the applicable accounting frameworks, of the AQR findings in banks’ forthcoming accounts. The banks will generally be expected to reflect AQR findings in the latter.

The JSTs will review the conclusions of the banks and their statutory auditors in order to assess whether they are comfortable with the way the AQR results have been incorporated into the accounts and, if necessary, to consider the use of available prudential measures to complement the accounting treatment.

6 OUTLOOK ON THE PROCESS AHEAD

The process of interaction between supervisors and banks over the next few months will follow the indications provided above in Section 4. Around the end of August, all banks will be informed of the exact calendar and modalities of the discussions of partial and preliminary AQR and stress test results. Further information on the submission of capital plans, including the relevant templates, will also be provided to the banks in due course.