



Danièle NOUY

Chair of the Supervisory Board

Ms Sharon Bowles
The Chairwoman
Committee on Economic and Monetary Affairs
European Parliament
Rue Wiertz
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Dear Ms Bowles,

Thank you for your letter of 11 March 2014, inviting me to an ordinary public hearing of ECON on 18 March. Your letter raises a number of additional questions relating to the implementation of the Interinstitutional Agreement, the Asset Quality Review, micro-prudential supervision and systemic risk.

Please find attached answers to these questions. I am ready to follow up on these answers in the hearing.

I look forward to our exchange of views tomorrow.

Yours sincerely,

Danièle Nouy

**Written questions to the Chair of the Supervisory Board ahead of the ordinary public hearing of ECON
of 18 March 2014 on the execution of the ECB's supervisory tasks within the Single Supervisory Mechanism (SSM)**

A. Implementation of the Interinstitutional Agreement

1. Section I.4. first indent of the Interinstitutional Agreement (IIA) provides that "the ECB shall provide Parliament's competent committee at least with a comprehensive and meaningful record of the proceedings of the Supervisory Board that enables an understanding of the discussions, including an annotated list of decisions". We understand that three meetings of the Supervisory Board have already taken place. However, the ECB has so far not provided ECON with any records of proceedings. Could you please indicate when and how the ECB will provide such records of proceedings in accordance with the IIA?

The transmission of a Record of the Proceedings of the Supervisory Board to the ECON Committee of the European Parliament is a key element in building up the accountability framework, as foreseen in the Inter-institutional Agreement.

The ECB aims at achieving the best possible balance between its transparency and accountability obligations, on the one hand, and the supervisory confidentiality constraints, on the other hand. The Supervisory Board has discussed the format of the Record of the Proceedings, which has now been approved by the Governing Council a few days ago.

After considering different options, the Supervisory Board decided in its meeting on 13 February 2014 that it would submit the records of proceedings on a quarterly basis to the European Parliament, together with the Quarterly Reports and that this practice would continue after the end of the Quarterly Reports from November 2014.

It means that the proceedings relating to the meetings from January to March would be transmitted by the end of April or beginning of May. This would allow a sufficient interval of time to allow the finalisation of the proceedings, while enabling full accountability to the European Parliament.

But the Supervisory Board also decided that "However, the record of proceedings would be provided to the European Parliament earlier, should the European Parliament ask for such transmission due to the relevance of some items discussed by the Supervisory Board, provided that decisions have been completed after a non-objection by the Governing Council".

B. Asset quality review/balance sheet assessment

2. Will the ECB disclose the assessment criteria for the balance sheet assessment?

On 11 March 2014, the ECB published the Asset Quality Review (AQR) Manual, providing full transparency on the methodology used for the AQR. The AQR Manual can be accessed at:

<http://www.ecb.europa.eu/pub/pdf/other/assetqualityreviewphase2manual201403en.pdf?e8cc41ce0e4ee40222cbe148574e4af7>

3. How did you evaluate the expertise and the independence of the auditors responsible for the balance sheet assessment? Did you check whether the auditors doing the balance sheet assessment were involved in the audit of the annual financial statements of the same banks?

The ECB provided clear guidance to National Competent Authorities (NCAs) on the third party procurement including recommended selection criteria for third parties. NCAs were asked to consider within the procurement process the professional and international capabilities and expertise of auditors including relevant market experience in SSM countries/Europe to ensure that the required services will be delivered on time, efficiently and to the highest standard.

To avoid conflicts of interests, external auditors must not have been primarily responsible for individual banks' regular audit in the previous two financial years or be engaged to do so in 2013. In addition, it is not possible to use the same auditors as in recent national AQR, Stress Test exercises or Balance Sheet Assessments.

4. Oliver Wyman was appointed to support the ECB in the preparation and implementation of the balance sheet assessment. What were the reasons for this decision and why do you think Oliver Wyman would be qualified to carry out such a task? Did a public procurement procedure take place before Oliver Wyman was appointed?

Oliver Wyman was selected following a procurement process in line with the European rules for procurement. The ECB received several submissions during this process. In the end, Oliver Wyman came out as the best performer on the basis of the selection criteria defined in the procurement process.

5. According to some press reports EBA and the ECB agreed in January 2014 on a definition of non-performing loans. According to those reports the loans in arrears of 90 days or more will be defined as non-performing. Given this is the case, how will the ECB avoid circumvention for example by rescheduling debts?

In the AQR a simplified non-performing exposure definition (NPE definition) will be used in: every exposure impaired, every exposure in default according to CRR and every exposure that is 90 days past due. This simplified definition has been agreed in consultation with the NCAs and the European Banking Authority (EBA). The simplified EBA definition serves as a minimum criterion that has to be applied by all institutions.

In addition, the treatment of forbearance and restructuring – including rescheduling of debts – is included in the review. Any issues identified in this area may have a material impact on the sampling and will be considered within the credit file review. In general, non performing exposures and forborne exposures will be included in the credit file review to the same extent, as they are both considered as high risk exposures.

6. Will a credit history be also taken into account where loans are defined as non-performing? What else could qualify a loan as performing or not?

Non performing exposure is defined as:

- Every material exposure that is 90 days past-due, even if it is not recognised as defaulted or impaired;
- Every exposure that is impaired;
- Every exposure that is in default according to the Capital Requirements Regulation (CRR).

For the purposes of the AQR the current classification of the exposures as performing or non-performing is relevant. But, for the collective provision analysis the percentage of performing exposure that moved to non-performing within the 12-month period between December 2012 and December 2013 as well as the recovery rate are taken into account.

7. Will the ECB accept that Spanish banks consider deferred tax assets as fully recoverable because allegedly the government guaranteed them? Does the ECB have a clear position on this?

For the purposes of the AQR the definition of Common Equity Tier 1 set out in the Capital Requirements Directive (CRDIV) and Regulation (CRR) will be applied, including the execution of CRDIV/CRR options by Member States and/or national competent authorities. National competent authorities are asked to ensure that the rules in CRDIV/CRR when determining the Common Equity Tier 1 ratio are fully applied by the banks.

8. How much time will be given to banks to raise capital if they failed in the asset quality review? Will that period be equal for all banks or will you decide individually?

The time frame within which the strengthening of capital positions must take place will depend on the respective outcomes. A shortfall relative to the AQR or the baseline scenario of the stress test will require the capital to be raised in the short term, while a shortfall arising from the adverse scenario of the stress test will require capital to be raised over a somewhat more extended period, on the basis of an agreed capital plan.

C. Micro-prudential supervision

9. What reporting obligations will be applicable for the non-significant banks not under direct supervision of the ECB? Will the ECB guarantee not to apply FINREP on non-significant banks?

The ECB will collect supervisory reporting on all supervised entities, both significant and less significant ones. The SSM reporting framework will be formed by the EBA Implementing Technical Standards (ITS) on supervisory reporting and additional ECB regular supervisory reporting requirements. The additional ECB supervisory reporting requirements will aim to close ‘gaps’ in the aforementioned EBA ITS in order to ensure that the data needs for supervision are covered. The definitions of additional ECB regular supervisory reporting requirements are still under discussion. However, any additional ECB regular reporting requirements will be subject to a preceding consultation. Moreover, after publishing the final version, supervised entities will be given an adequate implementation time (around one year).

More specifically and in line with the principles that inform the SSM reporting framework, the ECB will collect Financial Reporting (FINREP) data from both significant and less significant supervised entities. Adhering to the proportionality principle, the FINREP datasets that the ECB would collect for less significant institutions would be “simplified” (i.e. reduced compared with the ones for the significant institutions).

- For consolidated reports of less significant institutions under International Financial Reporting Standards (IFRS), it is mandatory under Article 99 CRR to elaborate ‘full’ FINREP as regulated in the EBA ITS.
- For consolidated reports of less significant institutions under National Generally accepted accounting principles (GAAP), the ECB would collect from NCAs a ‘simplified’ version of FINREP and put in place a materiality threshold (to trigger a further reduced reporting for smaller institutions).
- For FINREP reports at ‘solo’ level of institutions already included in consolidated reports (subsidiaries or parent of groups dealt with in bullet above), the ECB would collect an even more ‘simplified’ version of FINREP (with the same materiality threshold in place).
- For less significant institutions that do not prepare consolidated reports (stand-alone without subsidiaries), the ECB would collect the ‘simplified’ version of FINREP and the same materiality threshold would apply.

10. Will the ECB stick to the principle of proportionality and not apply IFRS on banks which are not obliged yet to use IFRS? Will the ECB refrain from introducing IFRS for those banks by establishing reporting obligations or by using its powers under Article 24(2) CRR?

Currently it is not foreseen that the ECB will make use of its power (laid down in Article 24(2) CRR) to impose the use of IFRS for the compliance with prudential requirements (including regular supervisory reporting); this approach, shall, however, not prevent NCAs to exercise this discretion in accordance with the aforementioned article.

The EBA Implementing Technical Standards (ITS) include a FINREP version for reporters under IFRS and another compatible version for reporters under National GAAPs. Against this background, the FINREP data to be collected by the ECB, as described in the answers to Question 9, should be elaborated under IFRS or National GAAPs as employed by credit institutions.

D. Systemic risk

11. Do you agree that the creation of the SRM and the introduction of "living wills" will solve the "too big to fail" problem or do you feel that supervisors will not be able to take the right technical decisions because they will have to avoid harmful market reactions?

The policy framework for global systemically important banks has two aims: (i) to minimise the possibility of a bank failure by enhancing resilience, and (ii) to limit the impact of a bank failure by enhancing resolvability.

First, to enhance resilience three important measures have been agreed: (i) to have systemic banks hold higher buffers of capital of higher quality at all times; (ii) to have systemic banks draw up and competent authorities assess recovery plans in which they formulate the measures that they themselves can take to avoid the risk of failure; and (iii) to intensify prudential supervision of systemic banks. These important measures are provided for in the CRD IV/CRR and the SSM Regulation.

Second, to enhance resolvability of all banks (including systemically important banks), two important measures have in principle been agreed: (i) the development of a resolution regime instead of normal corporate insolvency procedure and (ii) the mandatory drawing up of resolution plans that set out the strategy to be applied for the resolution, which requires both identifying and addressing any impediments specific to the institution concerned in order to make efficient and orderly resolution possible. The BRRD will establish this regime and procedures to implement these two important measures.

A strong Single Resolution Mechanism (SRM), once adopted, will provide for a more integrated framework to apply these common rules and procedures across participating Member States, where systemically important banks operate.

Taken together, a credible regime for recovering or resolving distressed firms will reduce the risk of panicky liquidity runs. It will ensure that supervisors can and will take the right decisions, including – when applicable – determining that a bank, regardless of its size, is failing and should be handed over to the resolution authority.

12. How would you deal with a situation in which textbook supervision and resolution activities could cause market reactions with potentially irresponsible systemic effects?

First of all, clear and transparent (supervisory and resolution) frameworks will increase the predictability and thus limit any systemic market reactions after supervisory or resolution measures are applied.

Second, adequate planning, as well as cooperation and coordination between authorities when actions are taken, will also limit the risk of systemic effects.

Third, as a final remark, let me add that there is a degree of discretion to take financial stability consideration duly into account on basis of the authorities' assessments. In compliance with State Aid rules, Member States may choose a number of tools allowing the exit process to take place in an orderly manner, while limiting negative spillovers on the sector and on the economy as a whole.

13. Do you consider the lack of an effective resolution mechanism as a threat for the common supervision under the SSM and do you share the view that it would be better to rather not have any resolution mechanism than what the European Council proposes?

The Single Resolution Mechanism is a key complement to the Single Supervisory Mechanism. Whilst the SSM will become fully operational in November, it is crucial to also proceed swiftly to establish the SRM.

The SSM without the SRM would mean that issues relating to coordination and cooperation problems in resolution and the bank-sovereign nexus will remain, and a misalignment between supervisory and resolution responsibilities will be created. Therefore it is important that the time gap between the SSM and the SRM becoming operational is minimised.

Legislators should live up to their responsibility to create a well-functioning Banking Union. To this end, all parties involved need to show a willingness to compromise.

14. Could the lack of an SRM 'back-stop' result in a risk-averse ECB implementing too stern a Comprehensive Assessment?

Let me start by saying that the ECB will not, in any circumstances, compromise the rigour of the comprehensive assessment.

First, I make the assumption that Member States will honour their commitment and put in place appropriate public backstops on time.

Second, there is a clear pecking order of financing in case the Comprehensive Assessment exposes capital shortfalls: first private sources, then public backstops. This is entirely separate to any discussions on the SRM or Single Resolution Fund.

In case of recourse to public backstops following the Comprehensive Assessment, national resolution frameworks will be activated in the first instance. In the second instance, if

national backstops are not sufficient, instruments at the euro area/EU will apply. The European Stability Mechanism (ESM) can provide, through its normal procedures, financial assistance for the recapitalisation of financial institutions in the form of a loan to a Member State. Further, following the establishment of the Single Supervisory Mechanism, ESM Direct Bank Recapitalisation can also be used once the Eurogroup have reached a final agreement on the operational framework for Direct Bank Recapitalisation.

15. What are the chances that the "Comprehensive Assessment" will lead to portfolio sales in 2014 and early 20 15? How will the ECB guarantee the stability of the markets during that period? With which measures?

By increasing transparency of banks' balance sheets, the comprehensive assessment will help to remove the uncertainty about asset valuation and funding models, which is currently distorting bank funding and holding back private sector investment in European banks. Moreover, the exercise will accelerate any necessary loss recognition and other corrective actions.

Private sector has, first and foremost, the responsibility to take ownership of recommendations resulting from the Comprehensive Assessment. Market-based solutions to these recommendations may include recapitalisation through profit retention or equity issuance in the private market. Given the improvement of market conditions, such market-based solutions should be more feasible and likely than in the recent past. This 'positive' deleveraging will improve the financial soundness of a bank, which in turn will better support the provision of new credit to creditworthy borrowers.

To further underpin the credibility of the exercise and guarantee stability of the markets, there is also a responsibility for the public sector. We need solid and well-defined public backstops at the national and, as a last resort, at the European level, in case market based solutions cannot be achieved in a timely and realistic manner. I call on Member States to honour the strong commitments made and to have the necessary arrangements in place, including resolution mechanisms and public backstops, enabling them to respond promptly if needed to any vulnerability identified by the Comprehensive Assessment.