

***ECB SSM Press Briefing,
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**Transcript
of the questions asked and the answers given by
Ignazio Angeloni
Director General Financial Stability
on the Comprehensive Assessment in advance of the Single
Supervisory Mechanism**

Angeloni: Good morning everybody. It is good to see you all here. I see many familiar faces. Today we continue the dialogue, which will go on for several months, on the effort towards establishing the single supervisory mechanism (SSM) and, in particular, towards conducting the comprehensive assessment.

I am Ignazio Angeloni and I am Director General Financial Stability at the ECB. In this capacity, I am responsible for several aspects of preparing the ECB for the banking union, and, in particular, the single supervisory mechanism. Ed O'Brien, on my left, is a key "pillar" in the comprehensive assessment of the banks, and I have brought him here today not only because he is very knowledgeable, but also because I have a little bit of a cold today and if I lose my voice Ed will take over.

We have all realised by now that the comprehensive assessment is a very important exercise and a very important step in the preparation of the new supervisory mechanism. More broadly, it is also an important step for Europe towards repairing some of the damage caused by the crisis and moving over to a more robust and sound banking system. It is a heavily technical exercise involving banks, their balance sheets, recording, reporting and very careful checking. It therefore has a very heavy technical financial banking component, but it also has a very important communication component.

It is not only important how we do this exercise from a technical viewpoint, it is of crucial importance how this exercise is perceived and received by all the stakeholders, i.e. not only the banks, but also observers, the press, public opinion, the European institutions, the institutions at the national level, etc. That is why we are paying a lot of attention to the communication aspects of the assessment. We want to be transparent, we want to be open. Today is a first step in this regard and there will be more. It is of crucial importance not only how we present the material, but also how the material is reported. That is why we are offering our cooperation to you and asking for your cooperation in return. The material needs to be reported correctly, swiftly, thoroughly and in full to the relevant audiences.

This morning, we circulated a very short press release providing basic details of the assessment, as well as a more detailed note outlining how the exercise will be conducted from a technical point of view. I would now like to give you a brief overview of the goals of the exercise, its scope, i.e. what the institutions are going to be assessed on, the methodology we intend to follow, and, within the methodology, I will provide a few more details on the key components of the exercise, i.e. the asset quality review and associated stress test, and some technical details on how they will be conducted. I will then close with how and when the results will be presented, and provide some information on the follow-up to this exercise when it is completed next year, as well as on the communication aspects. These are the points I would like to quickly cover in the 10-15 minutes that I have at the beginning, before opening the floor for questions.

On the goals: we are well aware that first the financial crisis and then the recession together had a strong impact on the European banking system. It is no secret to anybody that this is the case and that the situation of the banks has been affected in a variety of ways. Let me just mention two. First, through the real economy: banks live in the real economy and off the contacts with the real economy. Thus, if the real economy is damaged by a crisis, for example, banks are bound to be affected. Second, in the case of Europe, the situation of the sovereigns has played a significant role: the portfolios of the banks have a significant amount – albeit not an exceedingly large amount, if you really look at the statistics – of sovereign debt holdings, a large part of which is often domestic bonds. There is therefore a certain home bias in the holdings, so the fact that the sovereigns have also been affected by the crisis since 2011 at least has been another channel through which banks have been affected. The banks and supervisory authorities at the national level have reacted to this situation and have adopted a certain number of corrective measures. A lot has been done so far, but weaknesses remain and there is still uncertainty surrounding the situation of the banking system. The goal of the exercise is therefore to remedy those weaknesses and dispel those uncertainties. In particular, we say in the note that you have in front of you that there are three more specific goals: i) to foster transparency, i.e. to make sure that correct information is provided on the real situation of the European banks; ii) to repair balance sheets in the specific cases deemed necessary, i.e. we want to prescribe and indicate the actions that the repair has to consist of; and iii) as a result of the first two, to foster confidence in the banks among all the major

stakeholders. First, there are all of those who entrust the banks with their money, i.e. the depositors, the holders of bank instruments. They have to be confident in the banks.

Second, there are the investors, who put risk capital into the banks. They also need to be reassured in order to foster the inflow of private capital. And third, there are the lenders to the real economy. The process of bank lending needs to be restarted.

Concerning the scope of the exercise, the SSM Regulation clearly states which banks are to be assessed. The exercise has to include at least all banks that are supervised directly by the ECB. The Regulation also states that the size of the banks has to exceed a certain threshold in relation to GDP or in absolute terms, to be supervised directly by the ECB. The Regulation therefore defines the significant banks under direct supervision and states that at least those banks have to be assessed. Since the data required to establish which banks are significant will be available only next year, there is also a “safety area”, around the threshold, of banks that we have decided to assess, just in case they turn out to be significant. Consequently, there are 128 banks on the list you have in front of you, which are of course scattered across various countries. Basically they are the most important banks, covering about 85% of the assets of the countries participating in the SSM. At the moment these are the euro area countries, but we cannot rule out that more countries will join later.

Moving to the methodology, basically we want the exercise to encompass all the main sources of risk. We don't want this to be a partial exercise, we want it to be a comprehensive exercise covering all the sources of risk, but in a selective way of course in order to make the exercise manageable. That is why we talk about a risk-based exercise. Risk-based means that we concentrate on those parts of the balance sheet where, based on existing information, we believe most of the risks are located.

The exercise will be risk-based and selective, but at the same time we want to make sure that there are no nasty surprises in other parts of the balance sheet. Minimum coverage criteria are therefore also applied to those parts of the balance sheet that are different to those on which we want to focus.

With these parts of the balance sheet, we want to do three things. First, we will conduct a broad-based supervisory risk assessment in order to look at all the potential elements of risk in the configuration of the balance sheet, i.e. the liquidity of the bank, the leverage of the bank, the maturity transformation, the stable funding of that bank. We call this a risk assessment and to do it we will also use a new system, which we are in the process of developing, to calculate and evaluate, based on a series of harmonised indicators for all banks, the risk of each bank. It is a scoring system that draws on the best practices of the existing supervisors at the national level. Such risk assessment systems are common practice in the international supervisory community, but with the European supervisory authority we are doing it in a different way, taking the best practices from all of them and developing a harmonised system that we will all use in the new mechanism.

Second and key building block is the asset quality review. This means looking specifically at individual asset items, individual exposures, and seeing if the information is there on all these items. What does the information reveal? Is that item allocated correctly? Is the risk on that particular exposure calculated correctly? Should it be reallocated to a different risk bucket? Individual items will be looked at in great detail, but of course on the basis of samples, because it is not feasible to do that for the millions or billions of items for all banks. We are going to be risk-based here also, looking at the parts of the balance sheets where the risk is more likely to lie. So, the risk-based assets quality review is key to assess what the quality of the bank's exposure really is.

Then we have the very well-known stress test that everybody talks about. This has a different logic to the asset quality review, because rather than looking at the items in a normal, baseline economic and financial situation, and assuming that that environment remains normal, the stress test assumes on the contrary that the environment becomes "abnormal". We are talking about stresses, extreme situations, unlikely situations that don't have a very big likelihood of happening, but still can happen. What will the banks' reaction be? Are they vulnerable to those particular stresses? That is another dimension of checking the risk; it is the extreme, it's a sort of tail risk.

So we have these three elements, and in conducting them, especially the second and the third, we will be assisted by probably one of the best-known international financial management consultants, Oliver Wyman. Oliver Wyman was selected by following a standard and very detailed procurement process, with several competitors who made submissions, which were evaluated. We followed the European rules for this procurement; Oliver Wyman came out as the best. It will consult us, ECB, at the centre. The national authorities will have their own adviser, their own consultants. Many of them are actually opting to use the same consultant. That's important, because there will be a better coordination, but what is important is that the whole process will be assisted, both at the centre and at the level of the national authorities by private sector financial advisers and auditors. This is crucial for transparency and for the professional quality of the exercise.

Let me be a little more detailed and technical regarding the asset quality review because that is a key part. We will go through three steps: the first is the portfolio selection. The portfolios that will be examined in more depth will be selected in a risk-based fashion. The coverage, the choice of portfolios, and the sampling, the determination of the sample size for each of these portfolios, will be done bottom-up and top-down: the national authorities will propose some of these portfolios and we at the centre will review and challenge their proposals, before selecting the portfolios for each national case. Then the execution, the actual review of the individual items, as I explained, followed by the collation or collection of results. The results will be put together and an evaluation will be made, including the comparison across countries, because of course one wants to be consistent. That's very important because it is a comprehensive single exercise.

Before all this, there is an additional critical step, the data integrity validation. That is part of the standard process in exercises of this kind. It means carefully checking that the data information in the files of the authorities is complete. It's very important to have information on the exposures. In some cases that information is not complete, and so we have to complete it at the start, or take this into account in the final assessment.

In choosing the assets to be examined, we want to be very broad-based. We want to look at all the relevant borrowers that can generate risk, such as the corporate, the small and medium enterprise, the retail, the institutional, the interbank, the sovereign and the real estate borrowers, etc. We are going to be risk-based, but very broad in the selection of portfolios and also in the type of instruments. So, if you allow me the technical terms, the available-for sale component, the held-to-maturity component, the loans and receivables and all the different accounting classifications in which the assets are divided.

Finally, there is the stress test. As explained in the note, the stress test is an exercise that will be conducted in close collaboration with the European Banking Authority (EBA). It is part of the EBA's mandate to conduct stress tests for the European Union as a whole, which includes the countries of the single supervisory mechanism (SSM), which are predominant in size, but also other countries that don't belong to the SSM. The EBA will conduct a stress test as part of its mandate and we, the SSM, will link up and collaborate – of course with focus on the SSM countries, but in a way that is consistent with that of the other countries. The reason why you will find less information in the note about the stress test than about the asset quality review is that our discussions with the EBA are still ongoing.

Let me conclude with information on the results, the communication and the next steps. An important thing to keep in mind is that all these elements that I have explained, particularly the three building blocks, will bring a set of information that will then be considered together, leading to a single comprehensive assessment. There will be no partial results for each of the steps, communicated at different points in time. There will be a process in which the whole exercise and its different parts will be conducted, and then a comprehensive judgement at the end. When is the end? The end is October 2014, shortly before the SSM is due to assume its operational responsibility. After the regulation is adopted in November 2013, we will have 12 months for the preparation. The comprehensive assessment is part of this preparation, so when the 12 months have passed, in October/November next year, the comprehensive assessment will have to have been finished.

The assessment will consist of the results of the analysis of the banks and also of the corrective actions, the repair component that I mentioned at the beginning. For some of the banks, there may be actions to be undertaken. These actions may differ in nature: they can consist in adjustment in the capital, adjustment in the structure of funding and maturity, the liquidity, etc. We cannot predict that now. It will depend. It is a comprehensive assessment so there are several aspects. Some of the assets will need to be sold; there may be asset separations. The whole range of supervisory actions may be in the scope of the corrective actions that can be undertaken, after the conclusion of the assessment. That will be part of the judgement

that will be formulated at the end, together with the timing within which the banks will be requested to undertake those actions, where they needed.

Our immediate next step now is to call meetings with the banks. The 128 banks concerned were informed directly by the ECB at 8 a.m. this morning. We are liaising of course with the national competent authorities at all levels, and we are in constant tandem with them. We plan to have the CEOs of those banks in Frankfurt in the coming weeks, not only to present some more details orally, but also to receive feedback, to have a first opportunity to exchange views and to establish an eye-to-eye contact, a personal link. That's the starting point. Since there will be a new supervisory authority taking over, we are beginning our relationship with the banks we are going to supervise. This initial step is really important. We want to do it well and we want to do it in collaboration with the national competent authorities, while keeping the process directly in our hands.

Question: You just said that at the end of the entire process, you will release one figure. I am just wondering what will happen between now and November next year. What kind of communication can we expect from you? How much more detail are we going to see on the methodology and so forth, or is it that from now on, we will all just have to wait until next year?

Angeloni: I did not actually say that we would release one figure. I said that we would release a comprehensive assessment. It can, of course, include figures, as well as judgements, immediate actions, follow-ups and timing issues, etc. That will be coming at the end. We intend to maintain a constant dialogue with you over the 12 months to come. It will cover the modalities, the state of play, how the process unfolds and how it is progressing, etc. It will reveal whether there are any obstacles and difficulties, and how we will deal with them, but nothing will be said on the final results. That is what I want to you to take home with you today. We are not going to give you final results, or important parts of the results, before we have completed the exercise. That would be misleading for you as well. It would mean that you might get some information and then, perhaps three months later, another element would become available, so that we would have to correct that information. That would not be good for anybody.

Question: Many markets participants see the ECB as just another actor. My question really is about the banks: as they go through this process, they may be actively derisking and deleveraging, which would have consequences for the lending channel to the real economy in Europe. And my question then is: how mindful are you of the consequences of the process and the impact it may have on weakening the growth glide path that we see in the euro zone currently and what would therefore would the ECB be ready to do, to counteract the impact of this stress-test process?

Angeloni: We are very mindful thereof. And one of the reasons why we are very mindful is the following: if you have read the regulation on the SSM, you will have seen that the SSM is both a macro-prudential and a micro-prudential supervisor. This is perhaps the first example in an international context of a supervisor that has an in-built micro-macro link, which is exactly what you are talking about. We are aware that the banks are preparing for what is coming; we know that because we talk to them. As is said in the regulation, we welcome some of their prior actions because they are preparing, and that will help make the exercise smoother. We certainly do not want to see – particularly in the present state of the economic cycle in Europe – a “wrong” form of deleveraging, a shrinking of assets or constraining credit, that may be detrimental for the real economy. We want those banks to take remedial action, which can take the form of capital increases. There are a number of remedial actions that can be taken, or that should be undertaken – possibly in preparation of, and certainly after the conclusion of the exercise if requested, but we will certainly take care to present those results and the remedial actions in a way that ensures that the negative economic consequences you have in mind are avoided.

Question: My question is about the definitions of capital that are being used for the individual parts of the exercise. If I have understood what I read this morning correctly, the definition of capital for the asset quality review will be that of 1 January 2014. For the stress test, it will be that at the end of the horizon. My question is: what do you mean by the end of the horizon? Is that three years or longer? And secondly, because these two parts of the exercise have two different definitions, can we then expect two different numbers to come up at the end for each of those parts, or will you somehow integrate them into one?

Angeloni: This is something that I should have covered in my initial presentation. Thank you for reminding me of it. First of all, we had a choice at the start as whether to be more backward-looking or more forward-looking in our definition of capital; to use the old so-called Tier 1 capital definition of Basel II and II.5, or to look forward and use the new definition of common equity in Basel III and the CRD IV. After some reflection about the pros and cons, we decided to be forward-looking. We have thus adopted the new definition. The new definition comprises several elements, two in particular. One is the definition of the required ratio, the X%, and the other is that which you have just mentioned: the definition of capital. So, what might the components of the capital be? For the required ratio itself, we have decided to be “fully loaded”, meaning that we have adopted the requirement of Basel III and the CRD, what they require when fully implemented, and have added an additional buffer of 1% to that. The 7% of Basel III and the CRD IV is itself composed – if you are familiar with the technical details – of the regulatory minimum of 4½% plus a conservation buffer of 2.5%. To this we have added 1% in consideration of several factors, including the fact that those significant banks are systemic in some way, either nationally or internationally. We thus have a very safe, but feasible, capital cushion of 8%, based on the definition of the CRD IV. So we will allow for all the transitional arrangements, making

allowances for all the transitional provisions that the CRD permits the banks to use in phasing-in the definition of capital over a period of time, namely between 2014 and 2018. That is why we have said in our communication that the definition of capital refers to 2014. I hope that I have answered the question. Now, the stress test adds a time dimension. It is dynamic, meaning that a certain number of years are taken into consideration in conducting the stress test. Since there is a process of phasing-in involved in the definition of capital, the reference date for that is the end of the stress test, but the year has not been decided. This is part of the discussion we are having with the EBA. This is a technical feature of the stress test. The end-year could be 2017 or 2018. We will have to wait and see. For each year, the definition of capital of the respective year would obviously apply. All this will feed into the comprehensive assessment – that should answer your last question. We do not want to attach any specific weight or importance to any of the three elements, but we want all three of the elements, the three pillars so to speak, the risk assessment, the asset quality review (AQR) and the stress test to provide input to an overall final conclusion or assessment, including the capital requirement. Do not expect to see – or ask us to present – a specific capital requirement for the AQR, and then a specific requirement for the stress test, and then some average of the two. We are going to present the overall conclusion and implications in an articulated way.

Question: Just following on from that point. So, just to understand, can you explain to us a little bit more how you are going to combine these findings into your overall view, specifically how you are going to combine the findings from the asset quality review and the stress test? In other words, do any weaknesses that are uncovered on a bank level in the stress test feed directly into potential capital requirements that you are going to impose on them?

Angeloni: Relative to the stress test, the asset quality review has strengths and weaknesses. The main strength, of course, is that you are looking at the actual situation. So if you find some problems and there is a problem that has already occurred, you have to take it into account right away. The weaknesses of AQR relative to the stress test are twofold, I would say. First of all, there is the lack of a time dimension – it is a point-in-time exercise. The second is that it assumes that “normal” economic and financial conditions prevail. So, it does not assume all the unlikely things that may be important in the end. And so, one has to consider those strengths and weaknesses in order to formulate the overall conclusion, which will come at the end a judgement. It will not be a mechanical one. It is going to consider in a systematic way all the technical elements, but in the end the conclusion will be a supervisory judgement.

Question: This is a follow-up. How do you ensure that you are doing the same for every bank then? Because it is a judgement and not mechanical.

Angeloni: This is the normal life of the supervisor, right? And the supervisor supervises many banks, they are different and you have to deal with that. We are not so concerned about that specifically, because that is part of the normal day-to-day activity of the supervisor, we are more concerned about the complexity of the exercise as a whole.

Question: You said in your presentation that communication is very important. But right from the beginning you seem to have a problem of communication with the European Commission regarding the interlinkage between the asset review and the competition rules. Do you expect to get, before the asset review, the green light from the European Commission for the preventive recapitalisation that Mr Draghi was asking for in the letter to Mr Almunia? How are the negotiations on that? Thank you.

Angeloni: I have seen the references to this in the last few days in the newspapers and the wires. I was a little bit surprised, because my impression, seeing the things a little bit from the inside, was that this is being a bit overblown. We have been in touch with the Commission's DG Competition all along. The ECB President has asked the ministers to provide backstops. The ministers have responded very well to this call already in the Council last month. They are still working on it, so I expect more communication from the ministers. The DG Competition framework, if you read it, is very complete, and I think it is very well written. It includes certain principles, which we share, and also includes, in Article 45, if I remember correctly, a number of specific exceptions for application in cases of financial instability, in cases of disproportionate impact, etc. I think we agree fully with DG Competition and the other authorities that the framework has to be applied correctly, including those exceptions which are in Article 45.

Question: [inaudible] ... Will they be blanket exceptions?

Angeloni: No, I do not think that the President mentioned the word "blanket". As I do not think the State Aid framework, if I remember correctly, mentioned the notion of case by case. It mentioned importantly, in Article 45, the potential risk for financial stability, the case of disproportional results, plus some other grounds for exceptions that I do not recall now. And these are the things that will have to be applied.

Question: I would just like to ask for the more general audience, what makes this exercise more credible and effective than the previous two EBA exercises? And I won't rehearse all the problems or concerns with the previous stress tests. But what makes this different?

Angeloni: Countless things. Let me mention two important ones. First of all, this is conducted by an authority that immediately after will become the banking supervisor. This means that whatever conclusions and follow-up actions are indicated, they will be monitored, checked and enforced by the supervisor, which is the same body as that which is conducting the exercise. Second, the EBA was not in a position in 2009 and 2011 to perform an asset quality review before doing the stress test. So that means that the statistical basis for the stress test was relatively weak. Here, as you have heard, we are going to combine the two elements, and this is a fundamental strength. I could continue, but...

Question: I wonder if you could go more into detail about how you are going to be looking at sovereign bonds. You have mentioned that a couple of times. First of all, how are you going to be valuing sovereign bonds? That seems to be a very political process, if you decide for example that Italian bonds or some countries' bonds should not be valued at market value. And is there going to be a capital requirement against sovereign bonds? Maybe you could give us more of a flavour of how you are going to be looking at that?

Angeloni: Yes. First of all, I noted, and I thank you for, the article that you published a few days ago on the front page. I thought it was a very good article, although I have been criticised for the part that was behind my shoulders in the picture. It was a little bit dry, but anyway...

The sovereigns are in scope. That is the fundamental thing that you have to take home. The sovereigns are in scope, they are part of the risks, and obviously they should be, because a main component of the risk developments in the last few years, starting in 2011, particularly came from the sovereigns and so it would be contradictory not to include them.

However, the sovereigns are particular exposures in the sense that there is no issue of, let's say, data validation to speak of because they are recorded as securities, they are in a large majority negotiated in active markets and so market prices exist. So the nature of the analysis is different than it is for loan and receivables, for example, that is clear. But there are other components of risk. There is a stress component for example. What happens if there is a certain movement, for example, in the sovereign markets in certain countries? And so that is why I think the breadth of the comprehensive assessment allows us to capture that component as well. If there was only an AQR and not a stress test, for example, and not a risk assessment broadly, the exercise may not capture the dimension of sovereigns; instead it does.

Question: Can you just walk me through a little bit more where the money is going to come from for this exercise if there are capital needs. It strikes me that when the US did this exercise, it put out a big amount of money. People would say "wow, that's a lot of money". Is the euro area going to be able to

do that? And if it is not able to do that, if there is not an impressive amount of public money that might be around if it is needed, does it kind of undermine the whole purpose of this exercise from the beginning? Thank you.

Angeloni: Well, this is an important question. We have been putting the accent on this, the President has talked repeatedly about it. I must say I was also struck, when I went back as part of the preparations here, looking at the communication initially issued by the Fed when the US exercise was conducted in early 2009, to see how the emphasis in that communication was placed on the backstops upfront, even in some cases before announcing the details of the exercise. This is a remarkable feature of the way the US exercise was conducted. In our case, we have a clear sequence, a clear ranking in mind. First of all, the private sector has to intervene if there is a need. And we believe that the transparency enhancement exercise that we are doing will facilitate that, because once markets know more and risks are priced better, investors are more ready to come in. That is a key factor. But of course we cannot rule out the possibility that, particularly considering that the results of this exercise all come in at the same time, there may be some bunching of needs, some crowding-out in some markets, and markets may not function perfectly in some situations so that the available capital funds may not be sufficient, or may not be so immediately, or within the necessary time frame. That is why the President said there have to be public backstops, in order to ensure that the end-point of the exercise is safe. This is where the public component of the recapitalisation can come in, and this is national first of all, given the state of the discussions in the European fora. But then there is also in the end a European backstop, through the ESM, with different conditions, different graduations and different modalities. The combination of the three elements – the private element, the national public support and the European support – provides a sufficient safeguard. Of course, this will be fine-tuned further in the political discussions.

Question: I have a question on the timetable. Could you say a bit more about what will happen when between November 2013 and October 2014? Will there be one note of paper for the banks?

Angeloni: The starting point in November is the portfolio selection. I suspect that portfolio selection will also entail some data collection, we will have to see what the authorities already have, and may require some contacts with the banks. That is the starting part. Then we will proceed with the further steps that I have described. I expect the asset quality review, which is the core of the exercise, to proceed in the middle part of the 12-month period I have indicated, and to be closely intertwined with the stress test. The stress test has potentially different components. It can be top-down or bottom-up, with different modalities, and it is closely connected with the asset quality review (AQR), in part because the AQR provides important information for the stress test in terms of the starting point. So there will be a close connection between the two, which is one of the reasons why it would not be possible or appropriate to communicate separate results for the different parts. They have to be closely connected.

Question: *I have one more question on this figure we can expect in October 2014. Will this be a capital gap or a figure for the Common Equity Tier 1 or what can we expect?*

Angeloni: It will not be a number. It will be an assessment. It will be an articulated, comprehensive judgement which will include a number, or numbers. But this will not be the only thing. The numbers will be explained, they will be made understandable and justified. That is very important. It will be the distilled outcome of a comprehensive assessment.

Question: *In this asset quality review you will not interfere with banks' internal models for the risk weighting of the assets, if I understand correctly, and I understand that this is too much to ask at this stage. But is this something you will address in future?*

Angeloni: The answer is "Yes". When you analyse the different items and you judge whether they are properly allocated, etc., this by its nature in itself may lead to changes in the risk weights because you may find that an asset is not properly allocated and belongs in a higher bucket so you one has to apply a different risk weight. This leads to a possible re-calculation of the total risk-weighted assets; is something we certainly want to do. The thing that we thought that we would not be in a position to do in the time frame, is to go back and re-check and validate the models which were used to calculate those presumably not fully correct risk weights. But this is part of the "bread and butter", the daily work of the supervisor. When the SSM becomes a supervisor then, during the normal supervisory cycle, it will have the duty of actually checking and validating the models. That is part of the classic Pillar 2 evaluation of every supervisor.

Question: *[inaudible] ... Would you also consider harmonising the way assets are weighted in terms of risk?*

Angeloni: No. The models are not harmonised. According to the existing regulations, internal models can be used. By definition and by construction, internal models are not harmonised. But what should be harmonised are the criteria that are used to validate those models and deem them acceptable. There can be a variety of them, but all of them have to be acceptable.

Question: *There are currently reports in the German media that it has been decided to appoint the French supervisor, Danièle Nouy, as head of the SSM. Can you comment on that?*

Angeloni: I do not know of those reports. I can tell you that the selection of the Chair is an open and transparent process. We published a vacancy notice, and the deadline for applications expired a few days ago. So, now the applications are in and the selection process can begin. The process entails that the

Governing Council of the ECB indicates its opinion and that the European Parliament plays a strong role. Under the agreement that we have with the Parliament, they will receive a shortlist of names and will be able to express an opinion on that. Subsequently, they will receive the proposal and they have to approve the proposal before it goes to the Council. An international consultant is assisting us with the collection of applications and the selection process. So, we have taken all the necessary steps to ensure that this is a merit-based, transparent and effective selection process.

Question: I understand that the stress testing of government bonds looks like it will be a very powerful instrument, because you will have to decide what kind of stress you modulate. It could mean that sovereign bonds decline a lot in value. It could mean that all government bonds, including German ones, decline a lot, which is not very realistic, if you have the kind of crisis we had before. But it seems to be a very political exercise if you ask, for example, how would banks do if sovereign bonds were to decline by 10%, as this would have a big impact on Italy, Greece and other countries. If you do it differently, it will have a very different impact on different national banks, so it is a very political thing. How will you decide on that? And how will the political implications be assessed?

Angeloni: Indeed, as I have already indicated, these are among the strengths and weaknesses of the stress test. The strength is that it potentially has a very powerful impact. The weakness is that it is judgemental, in the sense that, not only is it model-based, but also the choice and articulation and detailing of the type of stress is judgemental. This is common practice, so we are not inventing anything: it is a process that stress testers have to go through each time. We will do this with the EBA, who have a lot of technical experience and have conducted tests already; we also have practical experience and we have learned from that. However, there is no doubt that a given stress has different effects on different sovereigns in different markets. There are certain types of stress that impact certain markets in one direction and impact other markets in the opposite direction, for example, owing to flight to quality mechanisms. A stress has to contain in itself sufficient articulation and a sufficient degree of realism in the way that it is constructed to take these elements into account. Once you have done that, you still have a stress scenario that is hypothetical, even if well designed. And so, in my view, this is another reason why you should not apply these things mechanistically. You should use these things as important elements or information in order to arrive at an overall judgement.

Question: How are you going to hire nearly 800 people that understand risk in a market where people that do understand risk are paid an awful lot of money by the banks that you are supposed to be monitoring? Also, could you speak about Oliver Wyman and what role they are going to play? Is there a risk of them playing poacher and gamekeeper? What assurances can you give us that this won't happen?

Angeloni: First, as far as staff are concerned, some months ago we started already, and are continuing still, to take on staff members – who are relatively young on average – on secondment from the supervisory areas of the national authorities. So, we already have some members of staff working in-house, and they are very active at all levels in the preparations not only for the assessment, but also for the future supervisor. These people, and we are talking about several dozens of them, are already present at the ECB and, of course, are very involved and very enthusiastic about the work they are doing. Many of them hope to join the ECB on a permanent basis, but for the moment they are on longer-term secondments with one-year contracts. The next stage is the regular recruitment process and so we currently have vacancies for senior managers. Once that stage is complete, we will issue vacancy notices for the middle managers. I expect many of them to come from the national authorities, but not all of them. There will also be open vacancies, so people from the market can apply. Thereafter, it is a little bit of a cascade, because once you have recruited a senior manager, they come into the picture and contribute to the recruitment of the lower level. So this will already be building up incrementally over the next few weeks. We already have scheduled in our calendars the selection panels for the senior managers and, thereafter, for the middle management.

With regard to Oliver Wyman, basically, there are three points in the process where Oliver Wyman's contribution is crucial. The first is in the design of the exercise. They have experience, as we do also in certain respects, partly from the programme countries as well as from other situations. In particular, they have very systematic experience in the design of these exercises, for example in the portfolio selection, the sampling criteria, where to look, how to apply the risk-based principle, etc. The second point is the execution. From an implementation point of view, execution essentially takes place in the field, so it is carried out largely by national authorities, where people from the ECB will also be present. We also want to include people from other authorities as well, who will go to different countries in order to work together on joint teams. The execution is local, but Oliver Wyman will help at the centre in making the process homogeneous and monitoring it. Alongside with us at the centre, Oliver Wyman will also receive the results and will check for comparability, do quality assurance, etc. A second phase thus consists of monitoring the quality of the process during the execution phase. The third point at which they will help is in bringing the results together and ensuring that these results are comparable, to the extent possible, and presented in a clear, understandable and transparent way. These are the three steps when we will be counting on Oliver Wyman to help.

Question: You want to take into account also the funding of banks. Could you please elaborate on the requirements? Will they be similar to the liquidity ratios as with the net stable funding ratio (NSFR) or do you plan to develop a new ratio? Thank you.

Angeloni: Here we have to be careful, because of two things. We are aware, of course, that these are very important elements. The lesson of the crisis, and the demonstration of that, is that the international financial reform process has focused on this aspect. The maturity transformation, the stable funding, the

leverage etc. are all aspects on which the international regulatory reform process is focusing, but it is still work in progress. That is the problem. We do not have a regulatory framework already fully in place. We enter, so to speak, in the middle of the process, but we are encouraged by the fact that we think that already next year – probably at the beginning of next year – the additional elements in the CRD IV will be included that relate to leverage, to the net stable funding, to liquidity cover – all these elements which come from the Basel III process will be incorporated already next year. So as we progress along in the months of next year, we will have a stronger regulatory basis to use, and we want to focus on these elements as well.

Question: I was just wondering if there is any consideration at all given to the global systemically important banks – the nine or so European banks that are considered even more systemically important. Obviously, there was nothing in terms of the capital ratios and I am just wondering if there is any discussion about that or if there is anything we can expect in terms of something different for those banks?

Angeloni: This belongs to the same category of issues that I just mentioned – aspects on which the Basel III and FSB process has focused – there is already an FSB definition of global systemically important banks (SIBs). In Europe we are still working on how to translate that. So we are aware of the importance of the issue, but we do not yet have a strong regulatory basis, though we want to take this into account. We will see how the regulatory reform process in Europe progresses in order to take this on board.

Question: Just one last question, taking a very wide view again of the point of this whole exercise, which is the first step towards the banking union, which is all part of severing the so-called doom-loop between sovereigns and banks. How can you frame that, though, in that argument? In what way does conducting this AQR and the stress test actually help solve that problem given that there is still no talk about any kind of euro zone-wide national back-stops and we are still talking about everything on a country level? Thanks.

Angeloni: The banking union – as I am sure you realise – is a broad and articulated project that includes several elements. The supervisor is in many senses the most advanced of these elements. That is more or less consistent with what the leaders concluded – remember, back in June 2012 they said that once the ECB supervises – I do not remember the exact words – once the supervisor is in place, then the ESM would be in a position to recapitalise the banks directly. So there is a sequence – obviously, the banks now have in their portfolio assets that people call legacy assets, so they pertain to a situation in which the national authority was still in control, and that is why we want to check that. That is an important element of the motivation for the comprehensive assessment – to see what the situation is as soon as this

new authority starts – and in the meantime we are working on the different elements: the backstops, the role of the ESM, the single resolution that we have not discussed, etc. So all these elements are in the making and they should eventually come into place, and all together they will form the banking union.