



COUNCIL OF
THE EUROPEAN UNION



Backstop mechanisms in the context of the 2011 EU-wide stress test exercise

*3088th ECONOMIC and FINANCIAL AFFAIRS Council meeting
Brussels, 17 May 2011*

The Council issued the following statement:

"The ECOFIN confirms that decisive steps are being taken to strengthen bank balance sheets as part of a comprehensive approach to ensure financial stability based on a new, transparent and strengthened EU-wide stress-test exercise. Together with the new requirements implementing the Basel 3 agreement, and as laid out in the forthcoming fourth revision of the Capital Requirements Directive, this exercise should provide the right incentives for banks to restructure their operations, improve their risk management, strengthen their capital base and liquidity profiles, thus contributing to improving financial stability in the medium to long run.

The ECOFIN in this regard welcomes that some banks have already taken measures to reinforce their capital base ahead of the publication of the stress test results. Such measures include restructuring, raising additional capital (either from their shareholders, on the market, or via public support) as well as other measures geared towards reinforcement of the capital base. This is a first, very positive, outcome of the stress test.

In line with previous conclusions of the European Council, any remaining pockets of vulnerability in the banking sector will be addressed decisively. Member States will prepare, ahead of the publication of the stress test results, and as part of a co-ordinated strategy, specific and ambitious strategies for the restructuring of vulnerable institutions, which will privilege private sector solutions but also include a solid framework for the provision of government support in case of need, in line with State aid rules.

P R E S S

As part of this co-ordinated strategy, the ECOFIN has confirmed that all Member States will ensure the availability of appropriate backstop measures for financial institutions that fail to meet the threshold of a 5% Core Tier 1 capital ratio under the stress test, as defined by EBA. Financial institutions with a Core Tier 1 capital ratio above but close to the stress test threshold will be subject to enhanced prudential scrutiny and remedial actions as appropriate.

In this regard, the ECOFIN specifically agreed on the following **common guiding principles**:

- With the objective of preserving financial stability, all Member States will have in place credible backstop mechanisms at the time of the publication of the stress test results. Backstop mechanisms will be co-ordinated closely among Member States, while allowing scope for country-specific situations where necessary. Such mechanisms will enable them to respond promptly to any vulnerability identified by the stress test, if needed.
- Any vulnerability revealed by the stress test will be addressed in a timely and decisive manner. Any institution concerned will be allowed a period of three months from the publication of the results to present clear plans to address vulnerabilities and a maximum of six months, i.e. until end of November 2011, to implement the necessary remedies (with flexibility allowed only if justified by market conditions or required procedures).
- Depending on each institution and country, backstop mechanisms may cover a broad range of measures, including both private and public elements, such as e.g. external audits, additional reporting requirements, reinforced monitoring, plans for capital conservation, capital increases, risk mitigating actions, liability management exercises, restructuring, sale of assets, transfers of assets to asset management companies, splitting of core and non-core activities and, where appropriate, merging of institutions to more viable units, orderly resolution, with the aim to accelerate the strengthening of the banking sector while preserving financial stability.
- Should the stress test reveal a capital need, private-sector solutions will be preferred. The use of public funds will be available only as a last resort, in case of need and subject to strict conditionality, to ensure full compliance with EU state aid rules, implying for instance that any public support will be contingent on the submission of a restructuring plan and be in line with single market principles. In addition, the implications of any use of public funds for the public finances will be adequately assessed.
- Home-host considerations in respect of cross-border financial institutions will be taken fully into account, including through early exchange of information and consultation among competent authorities prior to the publication of the stress test results.
- The use of backstop mechanisms in the Member States will be monitored on a timely and regular basis at national and EU level to ensure timely and effective implementation of the remedies as part of the co-ordinated EU-wide approach.

The availability and credibility of the proposed backstop mechanisms will be reviewed with all due confidentiality before the publication of the stress test results. The EFC has been tasked with this monitoring and peer review of all measures."