FINANCIAL TIMES

123

Last updated: October 27, 2011 1:05 am

EU pushes banks to find extra €106bn by June

By Alex Barker and Stanley Pignal in Brussels

Europe's banks will be forced to find about €106bn of extra capital by the end of June, under a mandatory scheme agreed by European Union leaders to temporarily bolster the defences of the banking system.

A recapitalisation plan overseen by the European Banking Authority will require around 70 banks to meet a higher 9 per cent threshold of the "highest quality capital", after revaluing sovereign debt at market rate.

European Union leaders, who signed off the proposal at a summit on Wednesday night, are betting the measures will help steady market nerves about the resilience of the financial system. A key test will be whether details of the plan – including the definition of capital and the method used to mark down sovereign debt – stand up to close scrutiny from analysts.

Of the €106bn capital shortfall identified, €79bn is attributable to the eurozone's so-called "peripheral" economies, with Greece (€30bn) and Spain (€26.2bn) topping the list, followed by Italy (€14.7bn) and Portugal (€7.8bn). Most of the capital required in Greece and Portugal is already covered by existing bailout programmes.

France has an €8.8bn shortfall spread over four banks, compared to €5.2bn for 13 lenders in Germany, a figure that is significantly below some analysts' predictions. About €7bn of the missing target capital buffers are linked to Volksbank group in Austria and Dexia in Belgium, which are already under deep restructuring.

EBA details EU measures to restore confidence in banking sector

Measures to strengthen banks' capital positions

The EBA will enforce a capital definition that is "largely based" on the stress tests it conducted last summer, which was closely linked to the "Basel III" standards. However there are some exemptions made for hybrid forms of capital – a key demand from some banks.

It is unclear whether Germany and Spain were entirely successful in a last-ditch effort to water down the recapitalisation scheme, pressing for different forms of capital to be counted towards the mandatory "temporary buffer" for banks.

The EBA will permit banks to include some forms of newly issued convertible capital, if it meets a "strict criteria". "Existing convertible capital instruments will not be eligible unless they will be converted into common equity by October-end 2012," the EBA added.

Spanish officials claimed the rules would permit around €9bn of convertible capital to be counted towards meeting the higher capital threshold. The provisions may also give a helping hand to some German savings banks.

Recapitalisation hawks see the decision on capital definition and the rigour with which the EBA implements the deal as critical to making the scheme a success.

"The EBA is invested with a big responsibility – they came up with the proposal, now they have to see it through and make sure there is proper implementation," said one senior figure involved in the process.

There has been a big variation in the EBA estimates of the capital shortfall, which is calculated once a higher capital threshold is set and sovereign debt is revalued at market prices.

The sum has risen from an initial estimate of €80bn to the latest estimate of €106bn, which is based on bank data from the end of June.

The EBA said the final estimate may still change once the most up-to-date information from the end of September is available.

Final figures will be available next month but the EBA has made clear that it will not publish bank by bank data, because it has no legal mandate to do so. It will, however, invite banks to make public their own figures.

The EBA in an explanatory note said the European Central Bank was ensuring that banks' short-term funding needs were met. But it argued that banks were struggling to tap longer-maturity funds, and said it was preparing co-ordinated action.

However, the EBA's plan relies on the resources of national governments and will not involve using any eurozone rescue funds to offer guarantees for bank bonds.

"The term [two-year plus] funding market is currently closed due to increasing concerns over the sovereign situation and banks may find it difficult to address their funding needs in 2012. Confidence in the market needs to be restored," it said.

"This can only be done through a three-pronged approach: addressing the sovereign situation, through banks recapitalisation and term funding guarantees," it added.

The plan gives banks until June 30 next year to raise the higher core tier one capital threshold and suggests that regulators will place restrictions on bonuses and dividends at institutions struggling to reach the threshold.

"Banks should be subject to constraints regarding the distribution of dividends and bonus payments until the target has been attained," the summit statement says.

While national regulators have powers to restrict bonuses in this manner, bankers expect the provision will have little practical impact on those institutions that are able to provide a credible plan for reaching the higher capital level.