



The EBA stress test 2014: A Credible Stress?

Paul Wessels
Erik Rood



Introduction – Paul Wessels and Erik Rood

Paul Wessels, PhD

Senior Manager

Financial Risk Management

KPMG Advisory N.V.



Experience

- PhD in physics, AMOLF (1997–2002)
- Postdoc in physics, University of Dusseldorf, Germany (2002–2004)
- Specialist in Risk Management and Asset and Liability Management, ABN AMRO Bank (2004–2010)
- Consultant/Manager in Financial Risk Management, KPMG Advisory (since 2010)

Erik Rood

Partner

Corporate Finance

KPMG Advisory N.V.



Experience

- Masters in Econometrics
- Structured Finance and Asset & Liability Management, ABN AMRO Bank (2000 – 2006)
- Valuations, Loan Portfolio Sales, Securitisation, AQR and Stress Testing, KPMG Advisory (since 2006)
- Leading KPMG NL IFRS 9 taskforce
- Leading KPMG NL financial instruments valuation team
- Leading KPMG Europe stress testing taskforce

FS Analytics at KPMG

Valuations of Financial Instruments

CVA/DVA/FVA

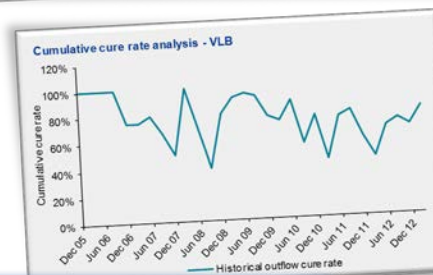
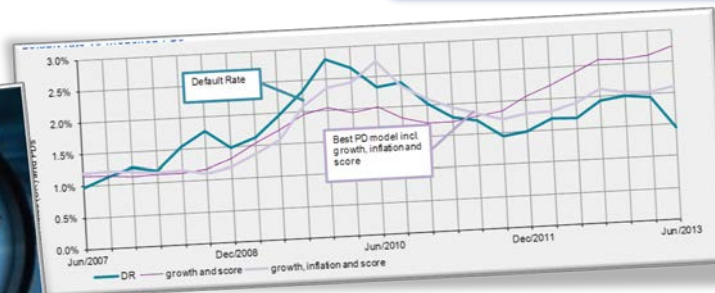
AQR & Stress Testing

Credit Risk Modelling

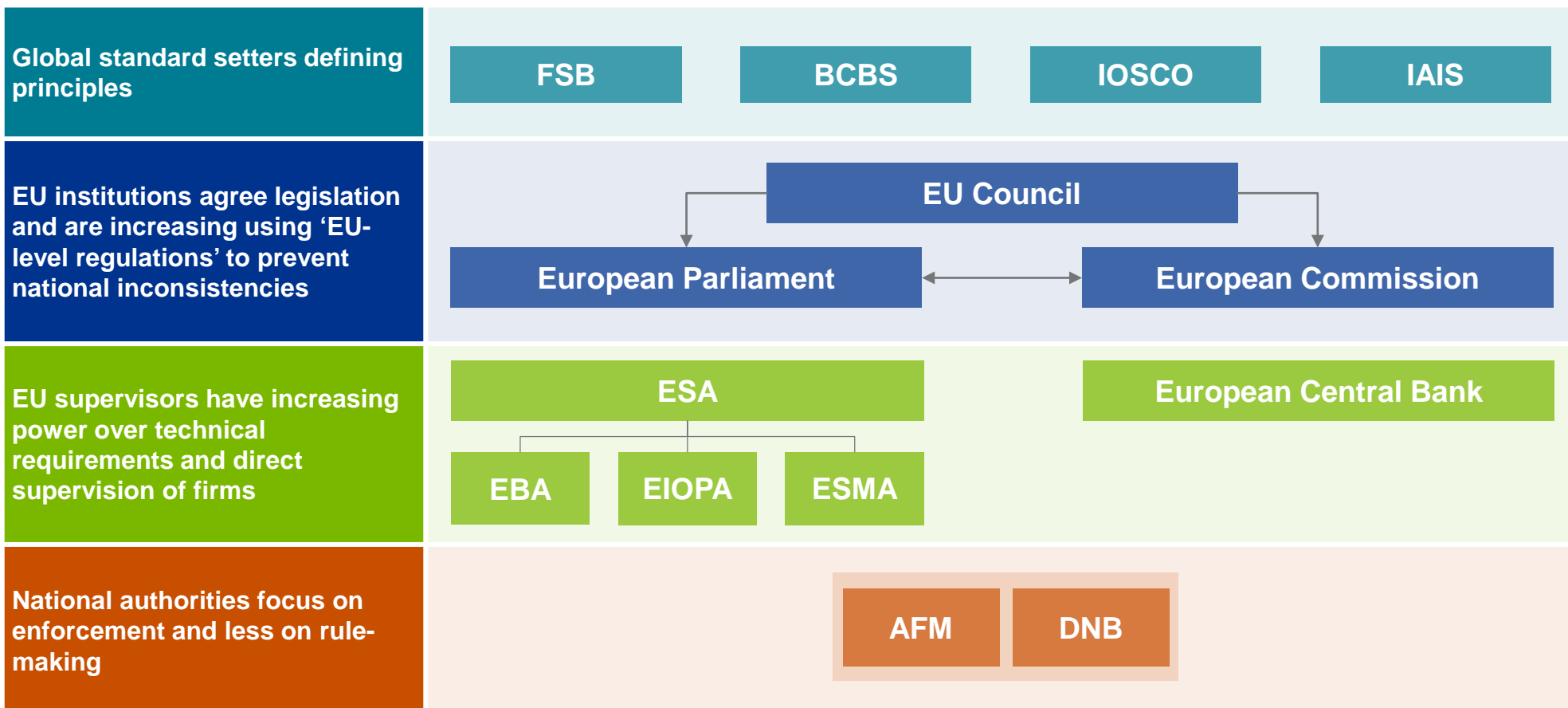
Market Risk Modelling

Basel Validation

Provisioning Models



The new layers of rule-making and influence



The rationale – Loss absorption capacity

“Against this background, the ECB conducted a thorough review of banks’ balance sheets and risk profiles, in preparation for the start of single supervisory mechanism.

More generally, this review will foster greater transparency in banks’ balance sheets and advance the consistency of supervisory practices in Europe”



Daniele Nouy, head of banking supervision at ECB

“This exercise is an excellent start in the right direction...”

Scope and supervision

- Ca. 130 banks in scope for CA of which 120 will be under direct supervision
- ECB indirect supervision on rest (some 3700 entities)
 - Supervision by National Competent Authority (NCA) teams
 - Oversight by ECB

Impact of NL



The EBA/ECB stress test 2014 – a credible stress?



ECB test is only the beginning
Financieele Dagblad

International media quotes (27 October 2014)

Wenn die Restauranttesterin zur Köchin wird
(*slager keurt eigen vlees*)
Handelsblatt

Europe's bank test celebrations mask mounting challenges
Reuters

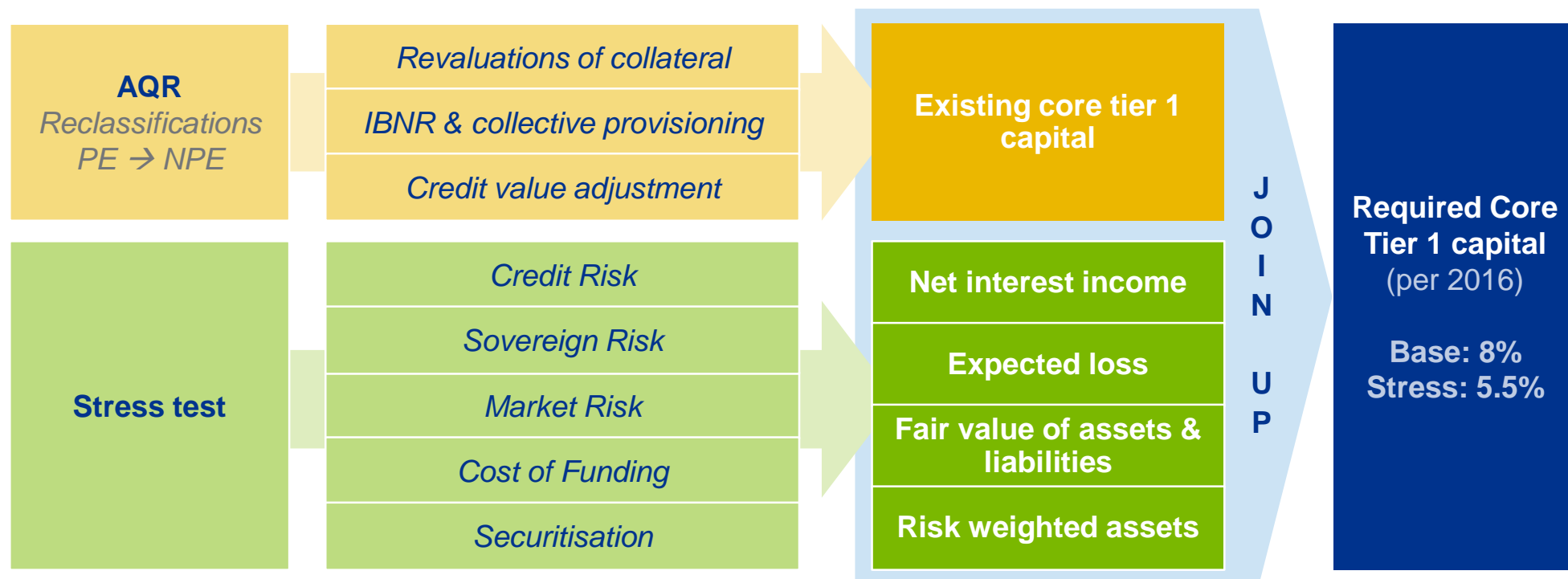
Europe's Banks Are Still a Threat
Bloomberg

Stress Tests Mark Step Closer Toward Eurozone Banking Union
Wall Street Journal

Gefahr für Steuerzahler: Auch der Stresstest macht die Banken nicht sicher
Der Spiegel

Der Test allein hilft nicht
Frankfurter Allgemeine

THE APPROACH – AQR and stress testing framework



Key assumptions

- ▶ Stable balance sheet
- ▶ Same business mix
- ▶ Replace maturing items with same items with same maturities

THE APPROACH - The ESRB stress scenario, an economic or political scenario?

Shock impact under adverse scenarios (cumulative figures)				
	2011-2012			
Country	GDP	COMMERCIAL PROP.	RESIDENTIAL PROP.	UNEMPLOYMENT
Netherlands	-1.5%	-19.0%	-8.2%	5.9%
France	0.6%	-33.2%	-15.4%	9.8%
Germany	-0.3%	-19.0%	4.8%	6.9%
UK	0.2%	-33.0%	-17.3%	10.6%
Italy	-1.1%	-19.0%	-4.8%	9.2%
Spain	-2.1%	-46.7%	-21.9%	22.4%

Previous stress –
EBA 2011 stress

**EBA 2014
stress**

	2014-2016			
Country	GDP	COMMERCIAL PROP.	RESIDENTIAL PROP.	UNEMPLOYMENT
Netherlands	-1.6%	-15.0%	-16.7%	9.6%
France	-1.1%	-4.7%	-28.1%	12.2%
Germany	-2.4%	-0.1%	-4.2%	7.0%
UK	-1.5%	-18.2%	-19.2%	11.5%
Italy	-3.2%	-7.9%	-15.3%	14.4%
Spain	-1.2%	-5.6%	-9.5%	27.1%

EBA stress test 2014

Portfolio perimeter of the EBA stress test

			P&L			RWA	
			Credit Risk	Market Risk	Funding risk	Credit Risk	Market Risk
Assets	Loans & Receivables	Amortised Cost	○		○	○	
	Corporate Bonds	Amortised Cost	○		○	○	
		Fair Value (AFS, FVPL)		○	○	○	
		Fair Value (HFT)		○	○		○
	Government Bonds	Amortised Cost	○		○	○	
		Fair Value (AFS, FVPL)		○	○	○	
		Fair Value (HFT)		○	○		○
	Securitisations	Amortised Cost	○		○	○	
		Fair Value (AFS, FVPL)		○	○	○	
		Fair Value (HFT)		○	○		○
Liabilities & derivatives	Liabilities						
	Debt instruments (fair value)			○	○		
	Wholesale funding				○		
	Customer Funding				○		
	Derivatives						
	Interest rate swaps			○	○	○	○
	FX swaps			○	○	○	○

EBA stress test 2014

Templates, templates,

The templates have been organised as:

Core templates

- Advance Data Collection (ADC)
- Calculation Support and Validation data (CSV)
- Transparency (TR)

Collection Type	Mandatory Templates	Additional mandatory SSM Templates
Advance Data Collection (ADC)	1.ADC_Credit Risk_MAN	
	2.ADC_Balance Sheet_MAN	
Calculation support and validation data (CSV)	9.CSV_Credit Risk_MAN	9a.CSV_CR_2014-2016_SSM
		9b.CSV_CR_Rating_SSM
	10.CSV_Funding_MAN	10a.CSV_Funding_SSM
	11.CSV_Evolution of P&L_MAN	11a.CSV_Evolution of P&L_SSM
	12.CSV_Market Risk Simp_MAN	
	13.CSV_Market Risk Comp_MAN	
		15a.CSV_AFS_FVO Assets_SSM
	16.CSV_Sovereign_MAN	
	17.CSV_RWA General Evo_MAN	
	18.CSV_RWA STA Floor_MAN	19a.CSV_RWA_IRB Floor_SSM
	19.CSV_RWA IRB Floor_MAN	20a.CSV_CVA&IRC_SSM
	20.CSV_RWA Trading Book_MAN	25a.CSV_Securitisation STA_SSM
		25b.CSV_Securitisation IRB_SSM

Many updates of the templates (including completely new templates replacing other ones)

Specification of extreme detail not accounting for complex operational/IT environment at banks

Changes in guidance and ad-hoc solutions in templates (suggested by NCAs/EBA/ECB)

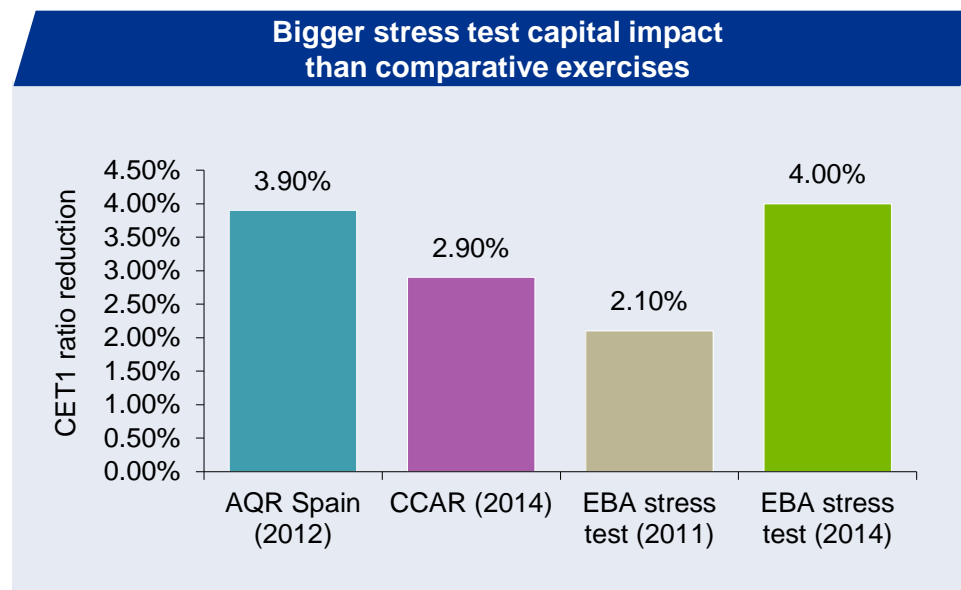
More than 2,000 Q&A from EBA/ NCAs and ECB; a number of Q&A was even circulated after the submission deadline

Some templates (e.g. 9 vs. 9a and 11 vs. 11a) almost the same but still with significant differences

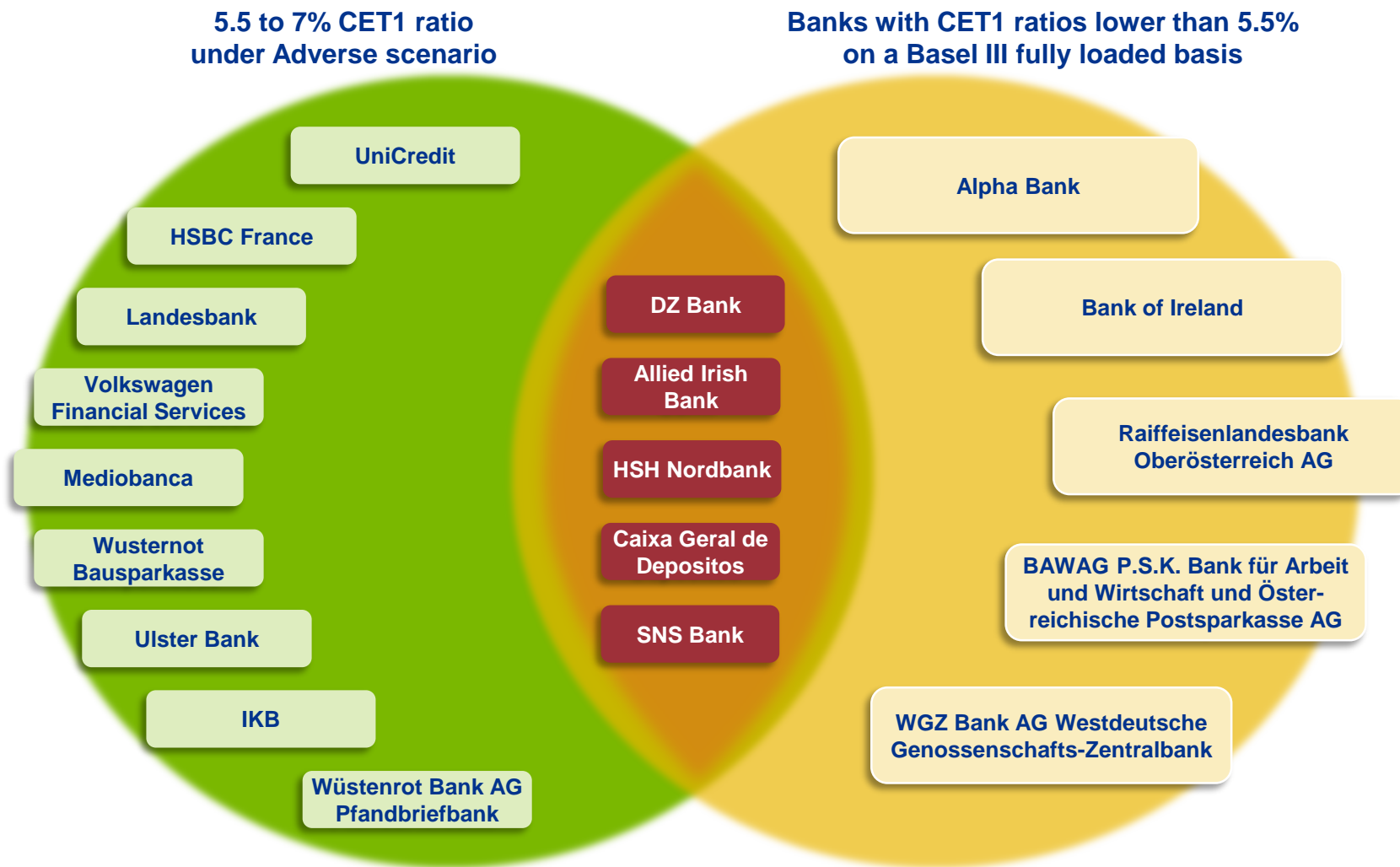
Challenge to map accounting reality onto economic reality, e.g. different treatment of hedge accounting and non-hedge accounting

Comprehensive assessment results

- **119,000** debtors analysed in detail and **170,000** collateral items revalued
- **1.5** million data points
- **18%** increase in NPEs across sampled portfolios
- AQR contributed **€13.4 billion** of the aggregate capital shortfall out of **€24.6** billion
- **25** banks failed, but proactive capital raising has reduced banks with capital shortfalls to only **13**
- A reduction of **4** percentage points in the CET1 median capital ratio of the 130 banks.
- **€263** billion capital depletion over the three-year horizon



20 banks may particularly wish to create additional capital headroom



Source: ECB/EBA; KPMG Analysis

Banks that are capital constrained with a particularly adverse RoE and NPE backdrop require early management action

Bank	Country	Capital constrained	Fully loaded CET1 Ratio below 5.5%	RoE	NPE	Coverage	DTA
UniCredit S.p.A.	IT	6.8%	6.5%	(35%)	11%	50%	Yes
DZ Bank AG Deutsche Zentral-Genossenschaftsbank	DE	6.0%	4.9%	15%	2%	43%	No
HSBC France	FR	6.6%	9.3%	9%	2%	43%	No
Bank of Ireland	IE	9.3%	2.9%	(7%)	14%	48%	No
Allied Irish Banks plc	IE	6.9%	(3.6%)	(18%)	22%	44%	No
HSH Nordbank AG	DE	6.1%	4.8%	(23%)	18%	34%	No
Caixa Geral de Depósitos, SA	PT	6.1%	4.9%	(8%)	16%	23%	Yes
Landesbank Berlin Holding AG	DE	6.8%	5.5%	7%	2%	37%	No
Volkswagen Financial Services AG	DE	7.0%	6.5%	16%	3%	57%	No
WGZ Bank AG Westdeutsche Genossenschafts-Zentralbank	DE	7.3%	4.6%	10%	0%	60%	No
Mediobanca - Banca di Credito Finanziario S.p.A.	IT	6.2%	6.2%	(0%)	3%	42%	Yes
SNS Bank N.V.	NL	6.8%	4.9%	(59%)	2%	24%	No
Alpha Bank, S.A.	GR	8.1%	1.3%	36%	36%	48%	No
Raiffeisenlandesbank Oberösterreich AG	AT	7.9%	3.9%	5%	6%	42%	No
BAWAG P.S.K. Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse AG	AT	8.5%	4.5%	10%	3%	38%	No
Ulster Bank Ireland Limited	IE	6.2%	n/a	(95%)	40%	66%	No
IKB Deutsche Industriebank AG	DE	6.5%	6.1%	33%	5%	41%	No
Wüstenrot Bausparkasse AG	DE	6.9%	6.9%	0%	2%	16%	No
Wüstenrot Bank AG Pfandbriefbank	DE	6.5%	6.5%	1%	2%	25%	No

Addressing NPEs alone will not fix profitability

ECB identifies €879 billion of NPEs across portfolios assessed consistently for the first time

Digging deeper, KPMG estimates:

Aggregate NPEs: €1.2 trillion, pre AQR adjustments

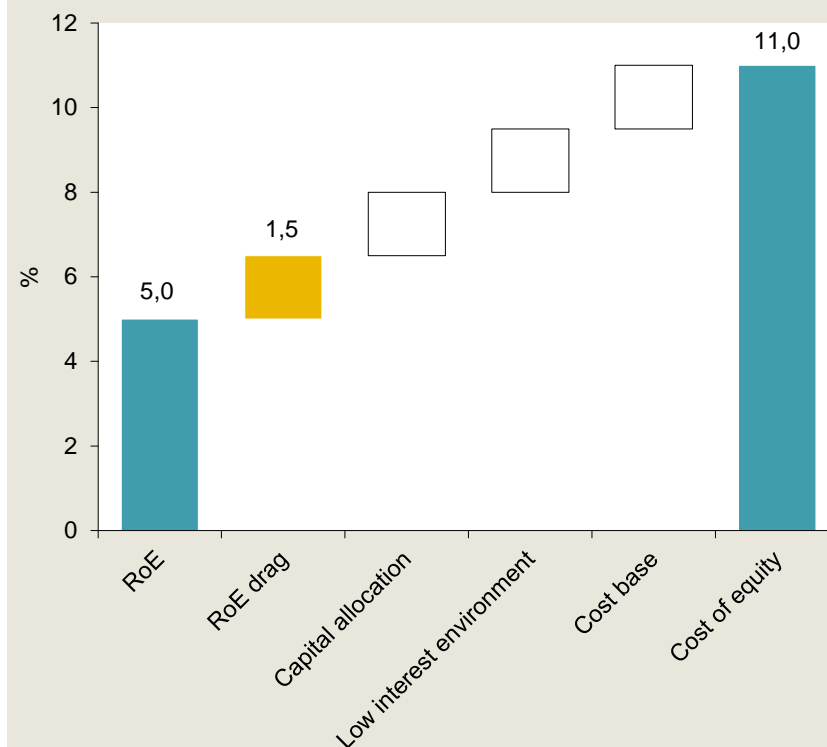
Capital tied up: €96 billion (10% of total capital for sector)

Capital tied up supporting NPLs could drive new lending of nearly €2 trillion in the sector.

RoE drag: 150 basis points

Concentrated and thereby undermining the most troubled national economies

Substantial challenges remain to bridge gap between COE and ROE





cutting through complexity

Thank you