

Eurozone: A Quick Look At The European Banking Stress Test Results

Background

The European Banking Authority (EBA) released the results of the second round of stress test on the European banking sector last Friday, July 15. The test was carried out on 91 European banks in 21 countries, which collectively represent 65% of total assets of the banking sector; and runs from 2010 to 2012.

The overall objective of the 2011 exercise was to assess the resilience of the banks involved against an adverse but plausible scenario. The scenario assesses banks against a deterioration from the baseline forecast in the main macroeconomic variables such as GDP, unemployment and house prices – for instance, GDP would fall 4 percentage points from the baseline.

The scenario includes a sovereign stress, with haircuts applied to sovereign and bank exposures in the trading book and increased provisions for these exposures in the banking book. Changes in interest rates and sovereign spreads also affect the cost of funding for banks in the stress. The stress testing methodology, which was published by the EBA on March 18, entails a static balance-sheet assumption, and also does not allow the banks to take actions to react to shock. The resilience of the banks is assessed against a benchmark defined with reference to capital of the highest quality – Core Tier 1 (CT1) – set at 5% of risk weighted assets.

Results

- The outcome was that out of the 90 banks reporting (list of banks can be found in the appendix attached), **8 banks had failed to maintain the capital threshold of 5% core tier 1 over the two-year time horizon**. Still, this was a number much lower than the market had anticipated, as speculation was that up to 21 banks could fail.
- A 9th bank, German public-sector lender Helaba, was poised to fail, but this week it forbade the EBA from publishing its results.
- The **net re-capitalising needs for these 8 banks are placed at EUR2.5 billion**, compared to a range of market expectations that stretched from EUR10 billion to EUR30 billion.
- The breakdown of the 8 banks that failed includes **5 Spanish, 2 Greek and 1 Austrian**. However, there were no Italian banks, as previously reported by the authorities. And all banks examined in Germany, France, Portugal, Ireland, and the UK passed.

Austria	Oesterreichische Volksbanken
Greece	EFG Eurobank Ergasias; ATEbank
Germany	Landesbank Hessen-Thuringen, known as Helaba (not included in EBA total)
Spain	Grup Caja; Unnim; Banco Pastor; CAM; CatalunyaCaixa

- Meanwhile, **an additional 16 banks display a CT1 of between 5% and 6%** under the test's "adverse scenario":

Cyprus	Marfin Popular Bank
Germany	HSH Nordbank; NordLB
Greece	Pireaus Bank; Hellenic Bank
Italy	Banco Popolare
Portugal	Banco Comercial Portugues; Banco Espirito Santo
Slovenia	Nova Ljubljanska Banka
Spain	BFA-Bankia ; Banco Popular ; Banco Sabadell ; Nova Caixa Galicia ; Bankinter ; Banca Civica ; Caha de Ahorros Y MP de Ontinyent

Comparing with the 2010 Stress Test Exercise

This is the second round of stress tests by European regulators, but the assessments are the first by the EBA since it was set up this year. The 2010 test was conducted by the Committee of European Banking Supervisors (CEBS), and was widely discredited for being overly lax and inconsistently enforced. It saw 7 lenders fail, with a combined deficit of EUR3.5 billion, a tenth of the lowest analyst estimate. In the latest stress test exercise, each bank was required to disclose roughly 3,200 points of data about its exposures to everything from Greek government debt to Danish derivatives to Maltese mortgage loans. In comparison, last year's exercise saw each bank revealing only 149 pieces of data.

Mixed Thoughts After The Results

Initial reaction to the test results, released after European markets closed, was muted. The Dow Jones Industrial Average closed Friday up 42.61 points (0.34%), while the Euro rose modestly against the US dollar.

While the test is in many ways tougher than last year's, the small number of lenders that flunked immediately provoked skepticism. Officials from the EBA had privately acknowledged that the exercise was not as rigorous as they would have liked, in part because of conflicting political pressures from regulators and banks across Europe. However, they said its value lies in the added transparency it will bring to an opaque banking system. Also, the tests do not look at the depth and stability of banks' deposits and other funding, or how the lenders would fare if a country defaulted on its debts.

Nevertheless, according to the EBA, the small overall number of failing grades reflects the fact that banks have scrambled for the past year to raise new funds in anticipation of the tests. Banks that were involved in the tests raised roughly EUR60 billion in the first four months of 2011; and if the tests had been conducted based on banks' year-end 2010 financial positions, 20 lenders would have failed, with a total EUR26.8 billion capital shortfall.

In addition, in a sign that the tests are having their desired effect, banks that failed moved quickly to beef up their capital. For instance, Volksbank AG, the Austrian lender that flunked, announced Friday morning that it is selling its Eastern European business to a Russian bank. Meanwhile, Greece's Eurobank EFG said Friday that it is entering into a "strategic partnership" with a Polish bank in an effort to drum up capital.

Concerns About Spain

That said, there are a lot of concerns about Spain, as 12 of the 24 banks that either failed or nearly failed are Spanish. Nearly half of the total capital hole of the 8 failing banks was concentrated in one Spanish lender, Caja de Ahorros del Mediterraneo, which needs to come up with about EUR947 million in new capital. The concentration of trouble in Spain indeed reflects the country's economic and banking struggles following the collapse of its real-estate sector.

However, the Bank of Spain, on Friday, said that the 5 Spanish lenders that failed the tests would not have to raise new outside capital because they already have sufficient funds in place, or have access to government aid. The central bank also pointed out that many of the Spanish economic scenarios were tougher than the European average.

Looking ahead

For now, identifying the weaker banking players is a good start. Banks whose capital buffers would fall short of 5% of their risk-adjusted assets under the test will be required by year end raise new funds by selling stock or shedding business lines or assets. Those that are unable to will have to turn to their respective governments for aid.

But the stress test alone is certainly insufficient to reassure markets. In the next few days, banking analysts will be re-calibrating their assumptions, sorting through the numbers to determine the credibility of the tests and to calculate the relative scores of those institutions taking part. The immediate focus for now, will be on an "emergency" Eurozone summit expected to be held on July 21.

Eurozone leaders will meet in Brussels to discuss a second bailout package for Greece and the financial stability of the Euro-area. The summit could prove a critical moment in determining what role private sector creditors play in further aid to Greece, and how leaders in the EU will stem the threat of contagion to Italy and Spain.

Appendix of Participating Banks

Country	Bank
Austria FMA OENB	ERSTE BANK GROUP (EBG) RAIFFEISEN BANK INTERNATIONAL (RBI) OESTERREICHISCHE VOLKSBANK AG
Belgium	DEXIA KBC BANK
Cyprus	MARFIN POPULAR BANK PUBLIC CO LTD BANK OF CYPRUS PUBLIC CO LTD
Denmark Danish FSA (Finanstilsynet)	DANSKE BANK JYSKE BANK SYDBANK NYKREDIT
Finland	OP-POHJOLA GROUP
France	BNP PARIBAS CREDIT AGRICOLE BPCE SOCIETE GENERALE
Germany BuBa BaFin	DEUTSCHE BANK AG COMMERZBANK AG LANDESBANK BADEN-WÜRTTEMBERG DZ BANK AG DT. ZENTRAL-GENOSSENSCHAFTSBANK BAYERISCHE LANDESBANK NORDDEUTSCHE LANDESBANK -GZ- HYPO REAL ESTATE HOLDING AG, MÜNCHEN WESTLB AG, DÜSSELDORF HSH NORDBANK AG, HAMBURG LANDESBANK BERLIN AG DEKABANK DEUTSCHE GIROZENTRALE, FRANKFURT WGZ BANK AG WESTDT. GENO. ZENTRALBK, DDF
Greece	EFG EUROBANK ERGASIAS S.A. NATIONAL BANK OF GREECE ALPHA BANK PIRAEUS BANK GROUP AGRICULTURAL BANK OF GREECE S.A. (ATEbank) TT HELLENIC POSTBANK S.A.
Hungary	OTP BANK NYRT.
Ireland	ALLIED IRISH BANKS PLC BANK OF IRELAND IRISH LIFE AND PERMANENT
Italy	INTESA SANPAOLO S.p.A UNICREDIT S.p.A BANCA MONTE DEI PASCHI DI SIENA S.p.A BANCO POPOLARE - S.C. UNIONE DI BANCHE ITALIANE SCPA (UBI BANCA)
Luxembourg	BANQUE ET CAISSE D'EPARGNE DE L'ETAT
Malta	BANK OF VALLETTA (BOV)

Country	Bank
Netherlands	ING BANK NV RABOBANK NEDERLAND ABN AMRO BANK NV SNS BANK NV
Norway	DNB NOR BANK ASA
Poland	POWSZECHNA KASA OSZCZ DNO CI BANK POLSKI S.A. (PKO BANK POLSKI)
Portugal	CAIXA GERAL DE DEPÓSITOS, SA BANCO COMERCIAL PORTUGUÊS, SA (BCP OR MILLENNIUM BCP) ESPÍRITO SANTO FINANCIAL GROUP, SA (ESFG) BANCO BPI, SA
Slovenia	NOVA LJUBLJANSKA BANKA D.D. (NLB d.d.) NOVA KREDITNA BANKA MARIBOR D.D. (NKBM d.d.)
Spain	BANCO SANTANDER S.A. BANCO BILBAO VIZCAYA ARGENTARIA S.A. (BBVA) BFA-BANKIA CAJA DE AHORROS Y PENSIONES DE BARCELONA EFFIBANK BANCO POPULAR ESPAÑOL, S.A. BANCO DE SABADELL, S.A. CAIXA D'ESTALVIS DE CATALUNYA, TARRAGONA I MANRESA CAIXA DE AFORROS DE GALICIA, VIGO, OURENSE E PONTEVEDRA GRUPO BMN BANKINTER, S.A. CAJA ESPAÑA DE INVERSIONES, SALAMANCA Y SORIA, CAJA DE AHORROS Y MONTE DE PIEDAD GRUPO BANCA CIVICA CAJA DE AHORROS Y M.P. DE ZARAGOZA, ARAGON Y RIOJA MONTE DE PIEDAD Y CAJA DE AHORROS DE RONDA, CADIZ, ALMERIA, MALAGA, ANTEQUERA Y JAEN BANCO PASTOR, S.A. GRUPO BBK CAIXA D'ESTALVIS UNIO DE CAIXES DE MANLLEU, SABADELL I TERRASSA CAJA DE AHORROS Y M.P. DE GIPUZKOA Y SAN SEBASTIAN GRUPO CAJA3 BANCA MARCH, S.A. CAJA DE AHORROS DE VITORIA Y ALAVA CAJA DE AHORROS Y M.P. DE ONTINYENT COLONYA - CAIXA D'ESTALVIS DE POLLENSA CAJA DE AHORROS DEL MEDITERRÁNEO
Sweden	NORDEA BANK AB (PUBL) SKANDINAVISKA ENSKILDA BANKEN AB (PUBL) (SEB) SVENSKA HANDELSBANKEN AB (PUBL) SWEDBANK AB (PUBL)
UK	ROYAL BANK OF SCOTLAND GROUP plc HSBC HOLDINGS plc BARCLAYS plc LLOYDS BANKING GROUP plc
Source: European Banking Authority	

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