Is the Comprehensive Assessment really comprehensive?

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Abstract

Analysing the database made available by ECB and EBA, we evaluate the Comprehensive Assessment (CA) - Asset Quality Review (AQR) and Stress Test (ST) - of banks carried out in 2014. In a nutshell, the main results are:

1. AQR to define a level playing field in Euro area, basis for ECB supervision
2. ST to determine the soundness of banks’ balance sheets

1. CA constituents

AQR and ST exercises have different goals:

- AQR to define a level playing field in Euro area, basis for ECB supervision
- ST to determine the soundness of banks’ balance sheets

2. CA in numbers

- 130 banks (103 banks for ST) in 19 countries;
- €22.1bn in assets, 81.6% of euro system under SSM;
- €5.5bn in RWA;
- 25 banks with capital deficit, Shortfalls (SF) for €24.6bn;
- Adj. for €47.5bn (AQR, €43bn for credit) + €215bn (adv. scenario ST).

3. Reference model

We focus on AQR SF & CA SF considering a set of exogenous variables:

\[ SF_1 = k + \theta_1 \cdot ced + \theta_2 \cdot \ln A_1 + \theta_3 \cdot \ln \beta_1 + \beta_1 \cdot npe + \theta_4 \cdot \ln P + \theta_5 \cdot c_p + \theta_6 \cdot mktCap + \sum \epsilon_i \]

- cet: common equity Tier 1 ratio
- Ir (leverage ratio): equity over total assets
- npe: non-performing credit exposure over total exposure
- cr (quality indicator of balance sheet): coverage ratio for npe
- sys (national champion): ratio of banks’ assets over country GDP
- mktCap: stock exchange capitalization over GDP (country index)

4. Main results: Shortfalls

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5. Further results

- Core vs non Core (Tables 8-9 in the paper):
  - Interactions: Ir, npe, sys. Differences (significant at 1% level) in AQR & CA
- Adjustments (Table 10 in the paper):
  - AQR: Weak evidence of bank-specific factors affecting the adjustment
  - CA: More severe for solid banks than banks in weak conditions (!)
- National discretions (Table 11 in the paper):
  - National heterogeneity in bank supervision at the root of CA’s results

6. Policy Implications

- CA: an important step towards a level playing field in the banking sector;
- ...however too concentrated on credit activity rather than financial assets;
- reinforcement of regulation on state aid at EU level: a possible change;
- focus of new Basel III rules on leverage ratio: an appropriate choice.

Bibliography Sketch

- V. Acharya and S. Steffen (2014) Benchmarking the European Central Bank’s asset quality review and stress test: a tale of two leverage ratios, Vox (November)
- V. J. Loz stable and S. A. Arouvaeva (2012) resolving risk-weighted assets, IMF working paper, 12/90

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**The SSNB at 1% SSB/EBendBank 2016