2021 EU Wide Stress Test
Our First Glance at Results

Highest capital depletion in stress history will not prevent the return of dividends and buybacks – Winners and Losers of Stress Test Results

July 2021

A&M

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Highlights

2021 Stress Test Results are out – Although results show highest capital depletion is stress history, given strong capital positions remaining buffers will allow increased dividends and paybacks for most banks

Stress Test Impacts

1

While 2021 stress test impacts increase compared to those experienced in last stress test 2018 …

- Impact of 2021 stress tests shows average capital depletion (2020 CET1 to adverse) of 485bps, 91bps higher than depletion created by 2018 stress tests (394bps)
- Much higher depletion explained by more severe scenario and worse starting point due to Covid-19 impact
- As expected stress test results do not generate any major surprises and demonstrate strong capital resilience of the banking sector coming off Covid-19

Capital Distribution

2

…banks demonstrate strong resilience to weather a stress due to improved capital starting positions.

- No incremental capital needs as capital actions pre-empted for banks (BMPS) falling below the 5.5% CET1 minimum threshold
- Capital flexibility measured as the buffer between CET1 after stress test and minimum threshold of 5.5% increases to 466 from 455bps in 2018
- New Pillar 2 guidance approach will bucket banks into 4 areas and create a stronger link between stress test capital depletion and dividend and buyback decisions
- Report shows winners and losers after application of new P2G rule

Summary by Country

3

Countries most impacted are those with least income generation capabilities to offset capital depletion generated by severe scenario

- Worst 5 countries by CET1 depletion:
  - Denmark: -651bps
  - Ireland: -607bps
  - Italy: -559bps
  - Germany: -558bps
  - France: -555bps
- Best 5 countries by CET1 depletion:
  - Poland: -112bps
  - Norway: -252bps
  - Spain: -290bps
  - Sweden: -299bps
  - Hungary: -303bps

Stress Tests Going Forward

4

Climate Risk Stress Test on 2022, and expecting material changes on 2023 Capital Stress Tests

- The Climate Risk stress test will arrive in 2022 expected to be very comprehensive and detailed, including three main modules (questionnaire, climate metrics and bottom-up stress test). It will require major bank preparation.
- Next capital stress test exercise in 2023 is expected to bring material new features: (i) supervisory run with top-down stress test view using simplified assumptions, (ii) banks run with bottom-up dynamic approach aligned to ICAAP and (iii) comparative results from both views

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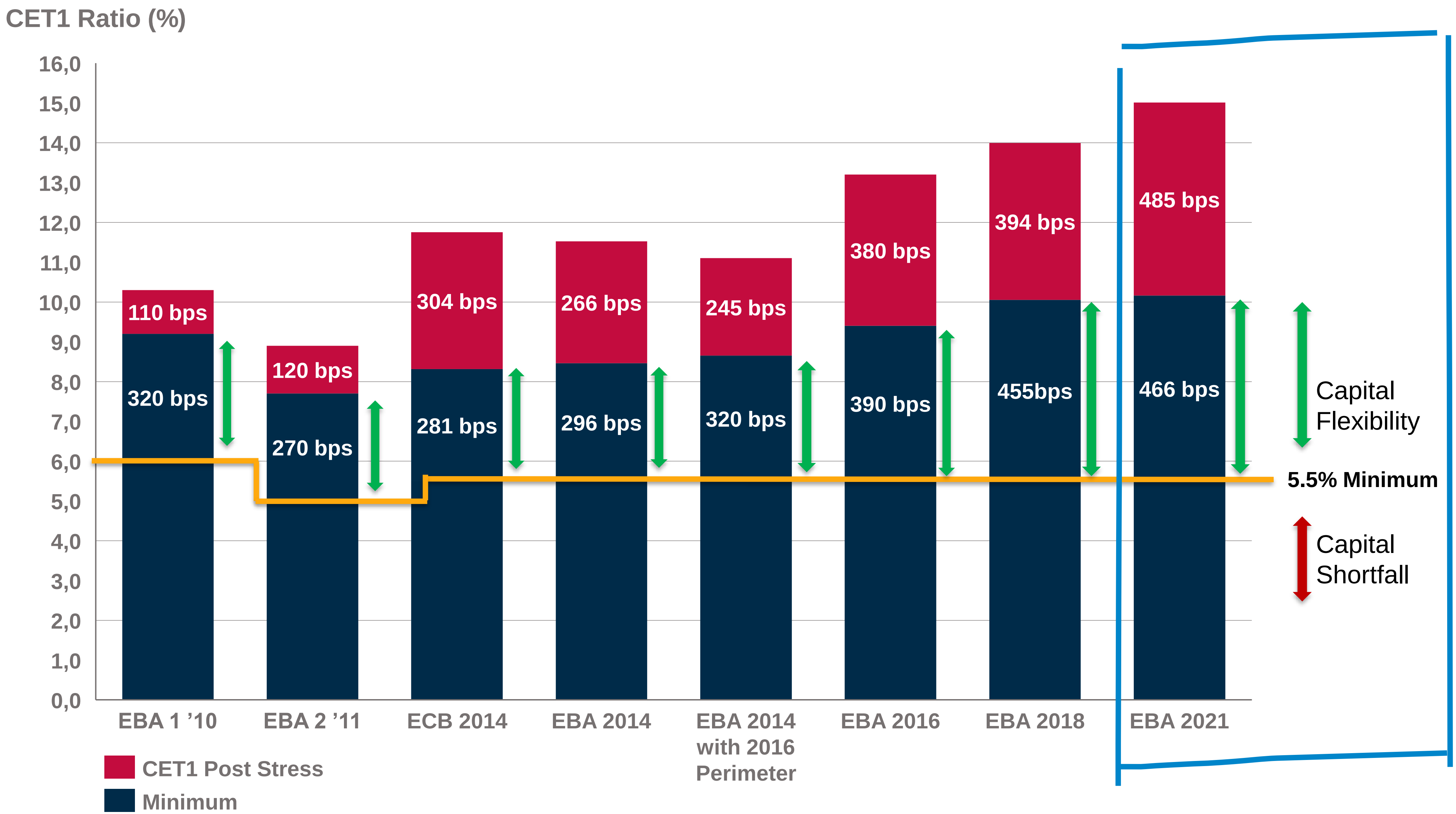
1. Stress Test Impacts

2021 stress test impact shows much higher capital depletion compared to ST'18 (measured as 2020 CET1 to adverse FL) (485bps vs. 394bps). Capital flexibility however presents better results (466bps vs. 455bps).

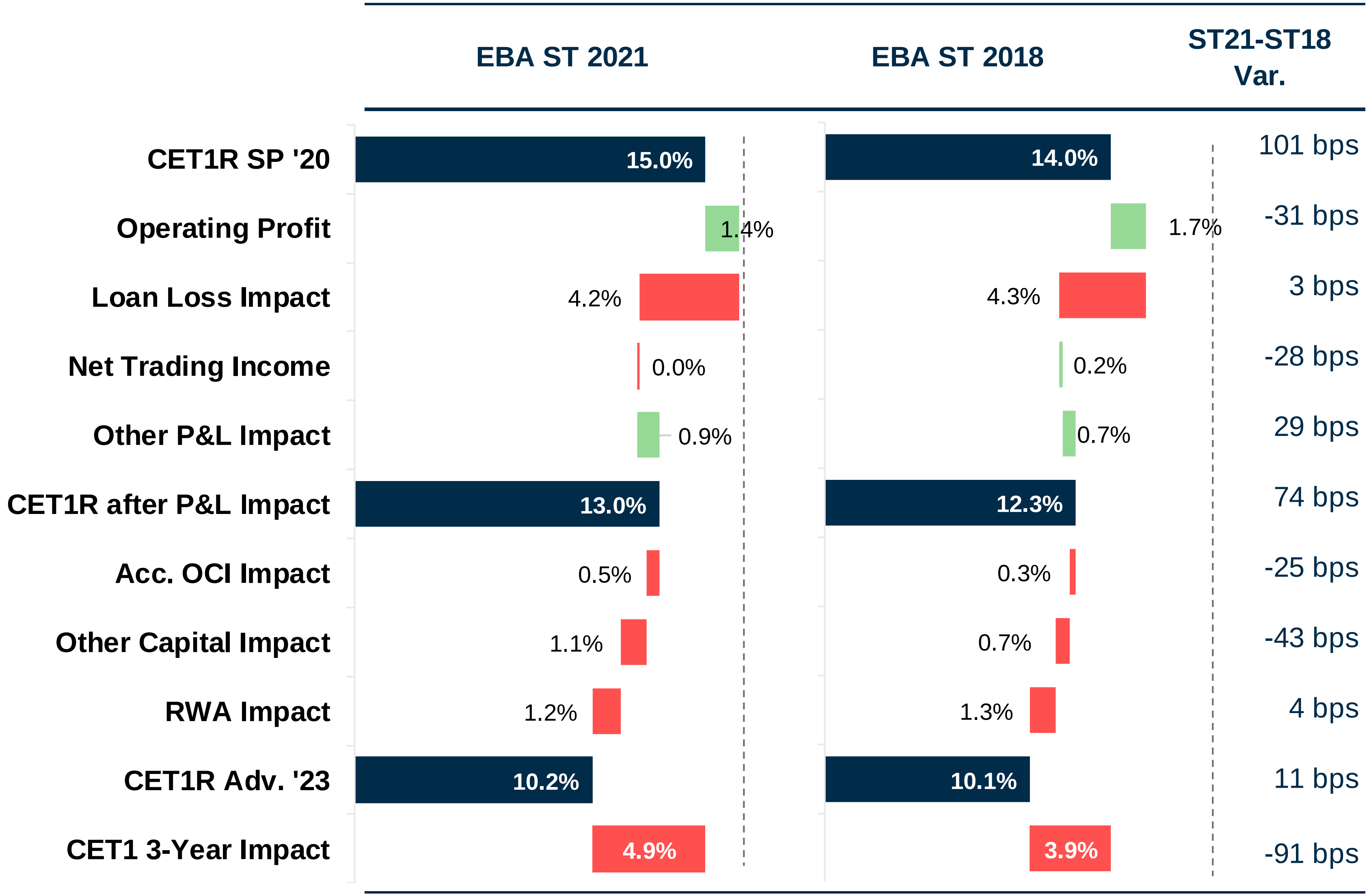
Total Depletion | Depletion by Country | Capital Waterfall



1. Stress Test Impacts

CET1 adverse depletion of 485bps (fully loaded) driven by loan losses (-420bps), Operating Profit (+140bps) and RWA impacts (-120bps). Compared to ST18, higher impact driven mostly by Operating Profit and NTI.

Total Depletion | Depletion by Country | **Capital Waterfall**

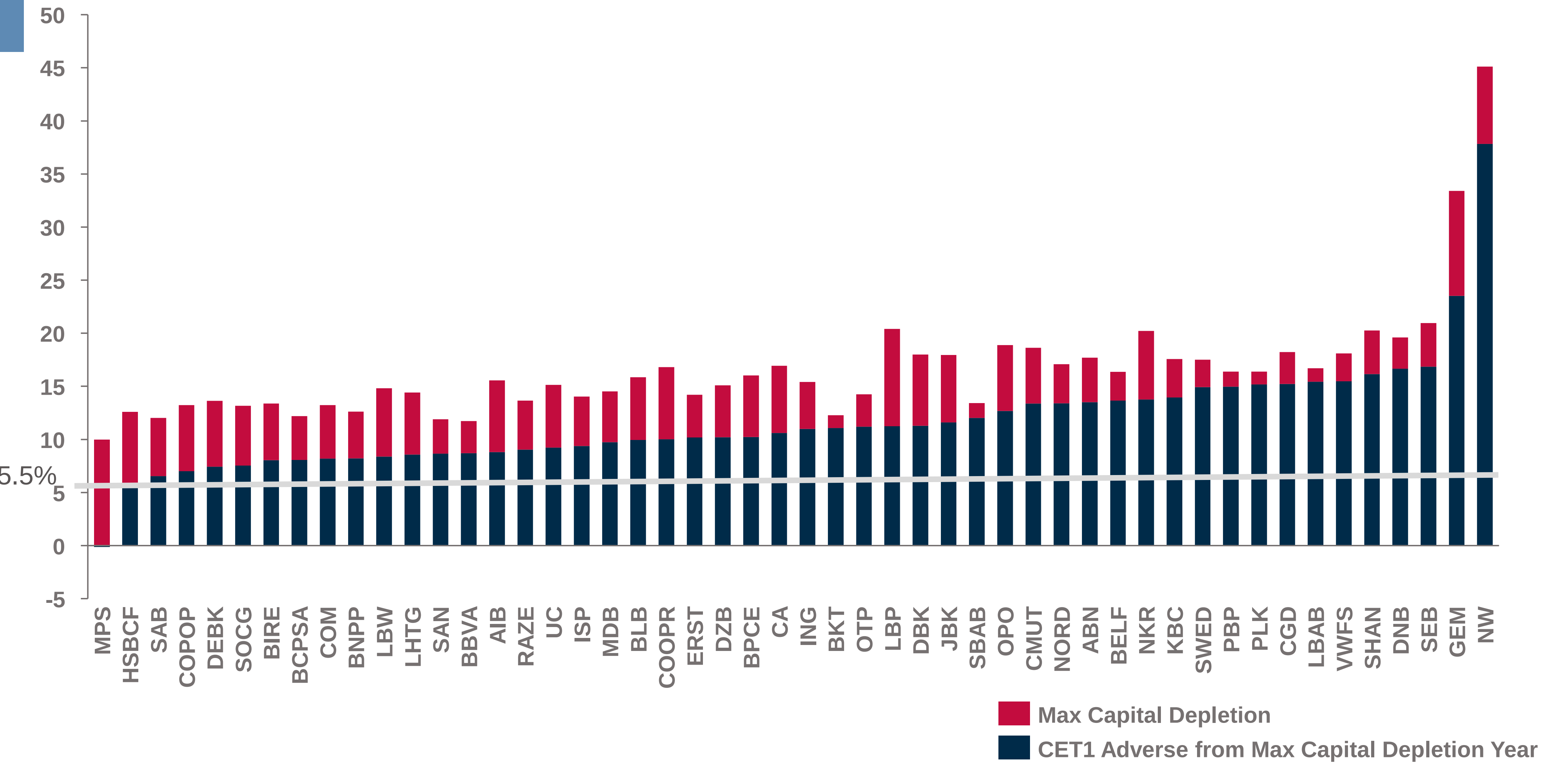


- Positive impact is interpreted as beneficial, while a negative impact is considered detrimental to capital

2. Potential for Capital Distribution - Dividends and Buybacks

No incremental capital needs as capital actions pre-empted for banks (BMPS) falling below the 5.5% CET1 minimum threshold.

Capital Flexibility | Pillar 2 Guidance



2. Potential for Capital Distribution - Dividends and Buybacks

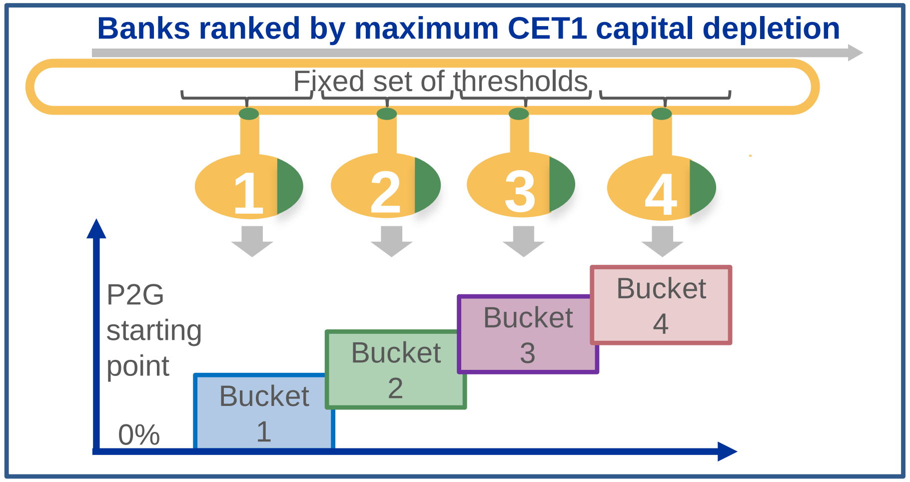
When assessing a bank's capital trajectory and its distribution plans, supervisors will take a forward-looking view duly informed by the results of the 2021 stress test and new approach to calculate P2G.

Capital Flexibility | **Pillar 2 Guidance**

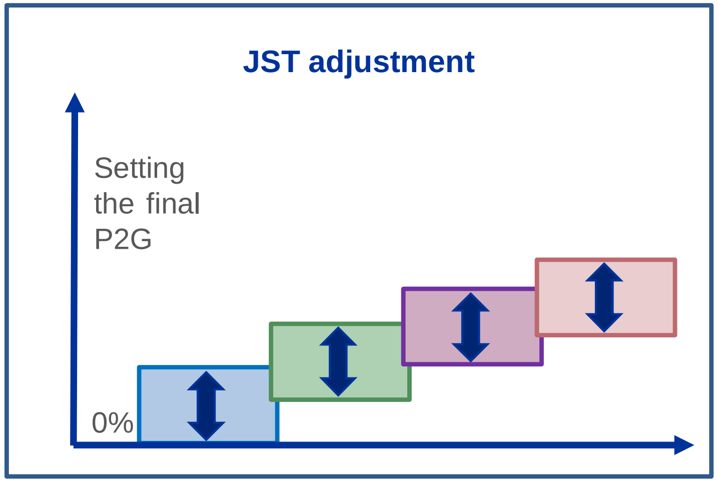
- P2G calculated from maximum capital depletion observed in CET1 adverse stress test multiplied by 25% calibration factor rounded up to the next 25bps

	Capital Depletion	P2G Range
• Bucket 1	0 to 3%	0 to 100bps
• Bucket 2	3% to 6%	50 to 200bps
• Bucket 3	6% to 9%	100 to 275bps
• Bucket 4	+ 9%	From 175bps

Step 1:



Step 2:



New methodology in line with recent EBA draft guidelines on SREP

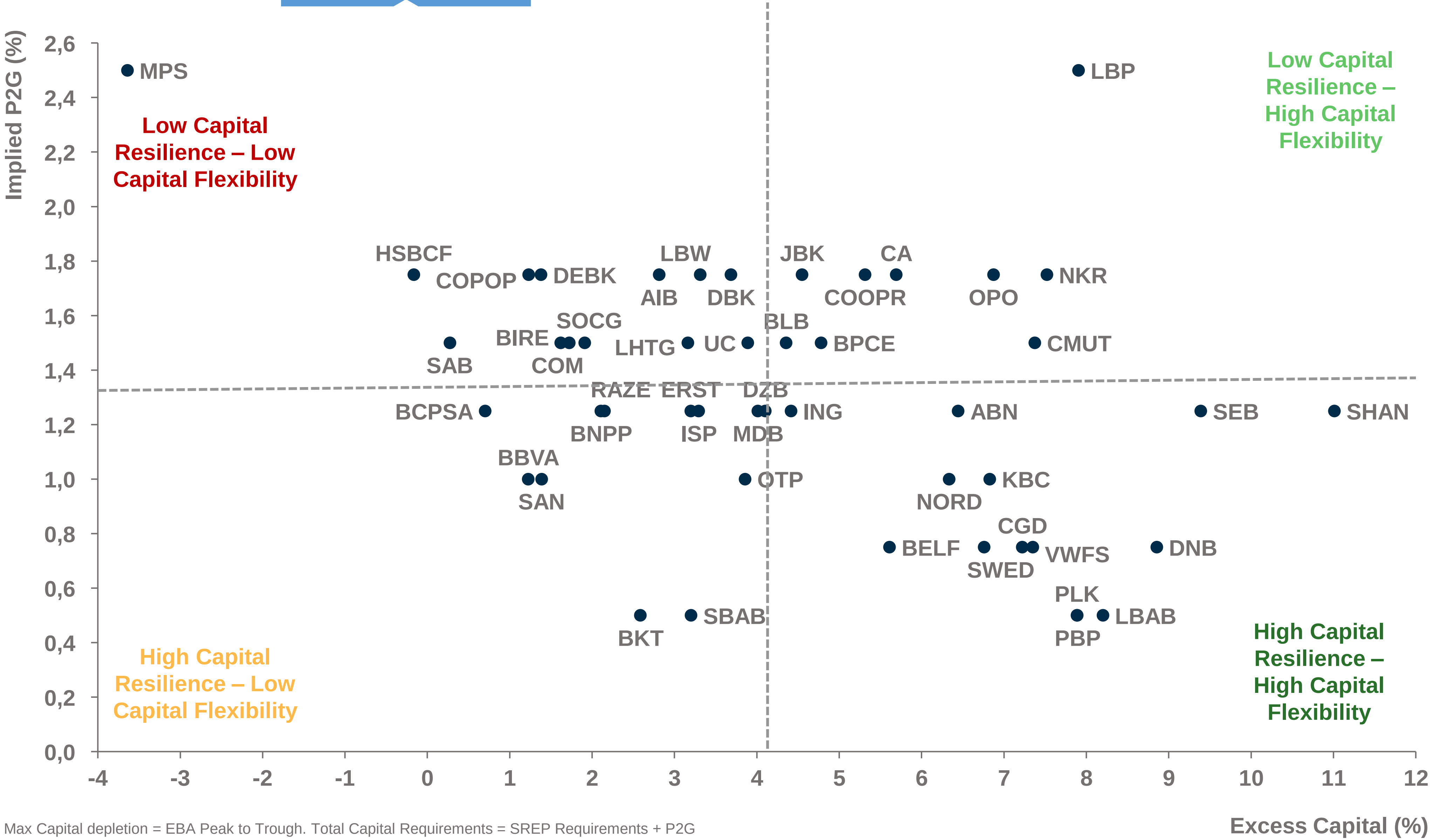
- **Step 1:** identification of the institution in a bucket according to the maximum CET1 depletion in the supervisory stress test exercise. Buckets calibrated according to **recent supervisory experience, SSM risk tolerance and severity of the stress test exercise.**
- **Step 2** JSTs expert judgement to adjust the P2G to the idiosyncratic profile of the institution. Adjustment within the ranges of the corresponding bucket and exceptionally beyond the range of the relevant bucket, including for the last bucket.

Enhancements: level playing field, consistency, no floors, no cliff effects (overlapping P2G ranges), institution-specific adjustments, reasonable range of P2G outcomes including in cases of high capital depletion.

2. Potential for Capital Distribution - Dividends and Buybacks

New P2G calculations will drive dividend / stock buyback decisions going forward.

Capital Flexibility | **Pillar 2 Guidance**



Max Capital depletion = EBA Peak to Trough. Total Capital Requirements = SREP Requirements + P2G
P2G calculation based on A&M estimates, measured as maximum CET1 * 0.25 (estimated factor), and rounded up to next 25 bps
Graphs divisions in banks distribution median
GEM & NW left out for visual purposes

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New ECB's Climate Risk Stress Test will arrive in 2022

CR ST 2022 will test bank capabilities to evaluate climate risk in three modules, which will require major banks' preparation

	Three Modules	Key Elements
ECB CR ST 2022	Questionnaire	▪ Goal: qualitative assessment of climate risk stress testing framework with 77 questions ▪ 11 areas including general use, governance and RAF, integration with strategy, methodology, scenarios, data, ICAAP, future plans, internal audit, parent company and bottom-up projections
	Climate Metrics Benchmarking	▪ Goal: benchmark banks' income reliance to transition risk sectors and financed GHG emissions ▪ Metric 1: Gross Interest and Fee Income from NFCs to cover 80% of income / max 5 countries ▪ Metric 2: Scope 1, 2 & 3 Emissions, Revenue and Loans for top 20 per sector non-SME corporates
	Bottom up Stress Test	▪ Bottom-up stress test projections for subset of banks under transition and physical risk scenarios ▪ 5 individual tests with different scope, metrics and horizons: 2 transition risk tests (one short term covering credit and market and one long term covering credit) 2 physical risk tests (one Drought & heat and one flood) and 1 operational & reputation risk test

Banks should prepare now. Climate risk is here to stay and should be taken as a strategic priority

			Priority	Actions
Areas for response	Data		HIGH	▪ Big challenge to capture GHG scope 3 data for Corporates and EPC / NUTS 3 data for Mortgages & CRE. Some data gaps for NACE 2 breakdowns.
	Models		HIGH	▪ Development of Transition Risk, Physical Risk and Operational Risk Models. ▪ Introduce dynamic projections over 30 year horizon for Transition Risk
	Scenario		LOW	▪ Scenario guidance provided with some needs for scenario extension
	Other	Climate Risk Framework	MEDIUM	▪ Need to develop and formalize climate risk framework, policy and procedures
		Documentation		▪ Need to develop comprehensive explanatory note for modules 1, 2 and 3
		Industry Collaboration		▪ Explore industry collaboration for sharing of methods and data (e.g., Scope 3)

Capital Stress Tests Going Forward will bring new features in 2023

The future of stress testing *(approach subject to be reviewed due to Covid-19)*

FIRST VIEW: SUPERVISOR

Supervisors Run Top-Down Stress Test using Simplified Assumptions

1

- Based on a constrained bottom-up approach
- Banks provide input starting position data
- Supervisors apply their models, benchmarks and assumptions to calculate depletion and challenge banks' results

SECOND VIEW: BANK

Banks run Bottom-up Dynamic Run

2

- Banks run in parallel their internal models using supervisory scenarios and bank internal approaches to incorporate idiosyncratic factors
- Banks use dynamic business projections and internal models aligned to ICAAP
- Models subject to constraints to ensure comparability across banks

THIRD VIEW: RESULTS

Final Results

3

- 2 sets of results: Supervisor and Banks
- Supervisor results serve as the starting point for Pillar 2 guidance. P2G could be implemented by buckets, based on capital depletion
- Lighter quality assurance and much less data published from the supervisor view. However, similar level of granularity required as part of the banks' view results

*Source: Speech by **Andrea Enria, Chair of the ECB Supervisory Board and former Chair of the EBA, on November 2019***
https://www.bankingsupervision.europa.eu/press/speeches/date/2019/html/ssm.sp191127~2f9bdabff9.en.html

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