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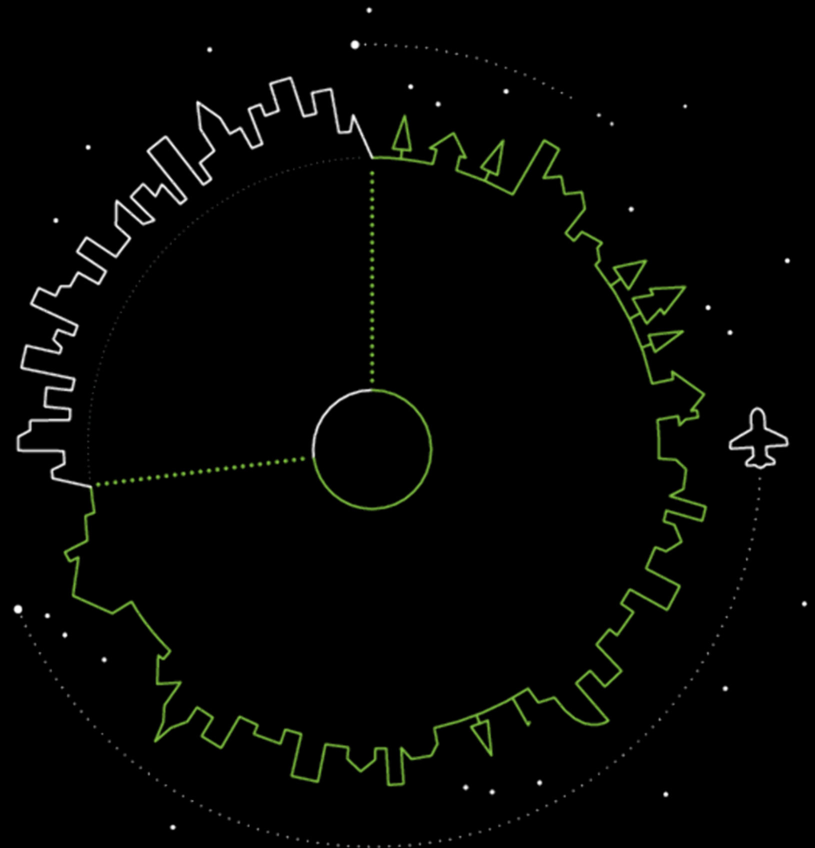


2016 EBA stress tests results

A stronger capital position, but expect a sterner test in 2018

September 2016

Executive Summary

The EBA exercise at a glance

51 banks from across Europe participated in the EBA exercise.

51
EBA banks

EBA banks submitted templates for EBA review and publication.

Other
SSM banks

Other banks under the SSM were subject to ECB scrutinty but results not published.

Goal
SREP Input

No hurdle rates, but results inform SREP discussions.

2
Scenarios

Baseline and adverse scenarios with static balance sheet assumption.

Our key takeaways

A stronger capital position, but expect a sterner test in 2018.

1

A stronger solvency position than 2014

Results demonstrate increased capacity of EU banking system to absorb credit losses. Only two banks would have failed test against thresholds imposed in 2014.

2

Credit losses still the biggest impact on CET1

Despite the improvement in credit quality, impairment contributes 57% of the downward movement in CET1.

3

New conduct risk methodology requires careful interpretation

New conduct risk methodology resulted in additional €71bn losses which more than offset the credit quality improvements since 2014.

4

Focus now moves to Pillar 2

SREP guidance expected to focus on this as well as level of capital depletion during the forecast horizon and qualitative aspects.

5

IFRS9 will create additional credit risk challenges

Introduction of IFRS9 in 2018 will likely lead to more intensive data and modelling challenges and ultimately to greater stress loss volatility amongst participating banks.

6

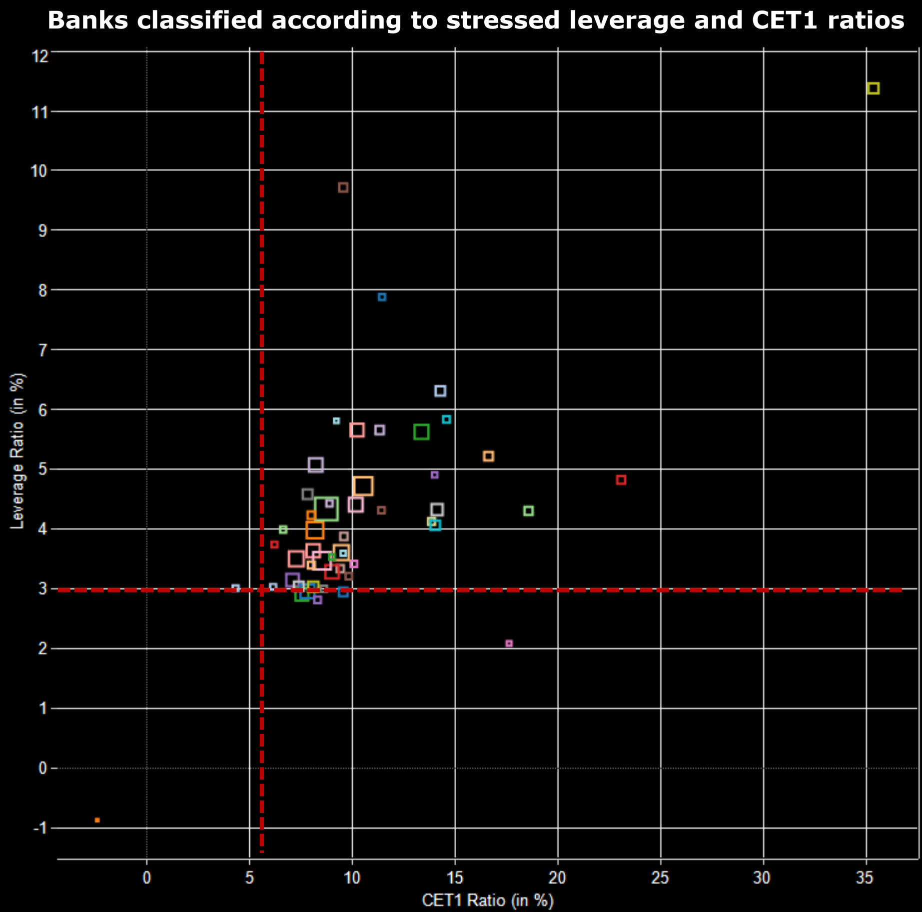
Stress testing highlights industry-wide issue of returns

Increased standards in stress testing exercises likely to lead to lower stressed returns and may reduce the attractiveness of the industry.

Results

1. A stronger solvency position than 2014

Results demonstrate increased capacity of EU banking system to absorb losses. Only two banks would have failed test against the 2014 CET1 imposed threshold.

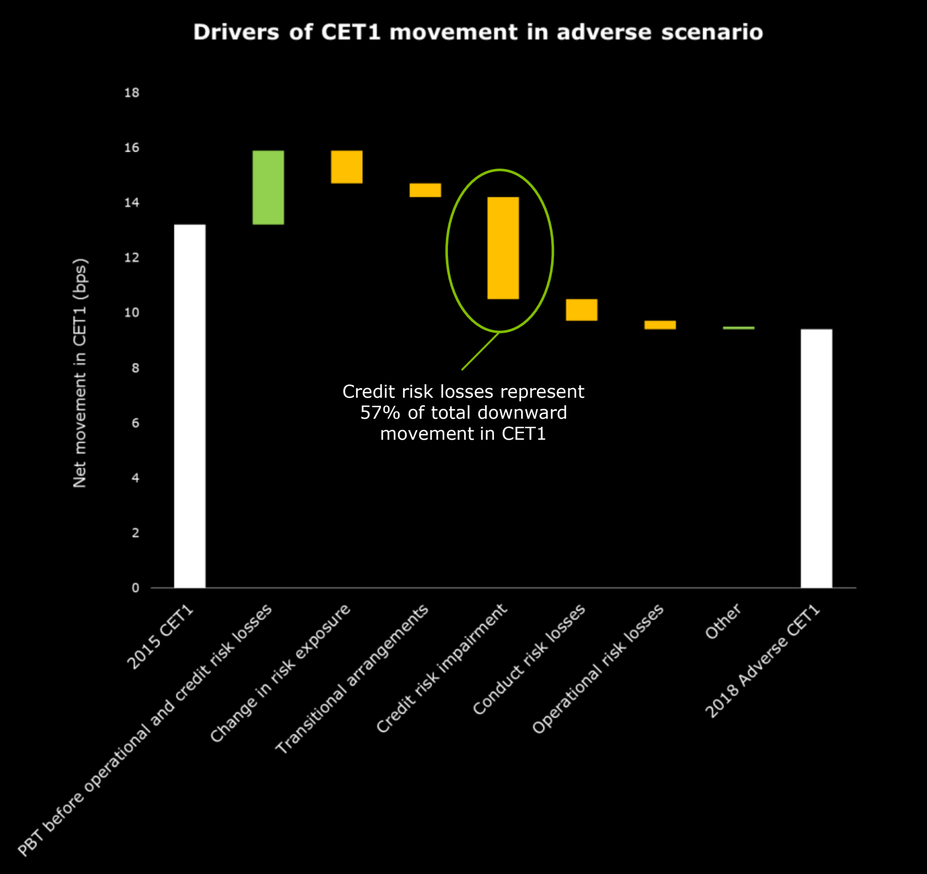


Note: Fully-loaded CET1 under adverse scenario
* Sample of banks tested differs between the two exercises.

- There was no pass mark in the 2016 exercise, unlike in 2014. We have considered limits based on the 2014 exercise - CET1 limit of 5.5% and 3.0% for leverage - to assess banks' solvency position.
- Under this assumption, eight banks would fail the exercise essentially due to a leverage ratio below 3%.
- Two banks (4%) breach the CET1 limit, down from 11% in 2014. The stressed leverage ratio was not disclosed in 2014*.
- The size of the bubbles in the graph on the left taken from the tool, reflects the CET1 capital for each bank. The majority of banking stressed capital is focused in an area just above both cut-off points with greater variability in smaller banks.
- The results demonstrate increased capital capacity of the EU banking system to absorb losses.

2. Credit losses still the biggest impact on CET1

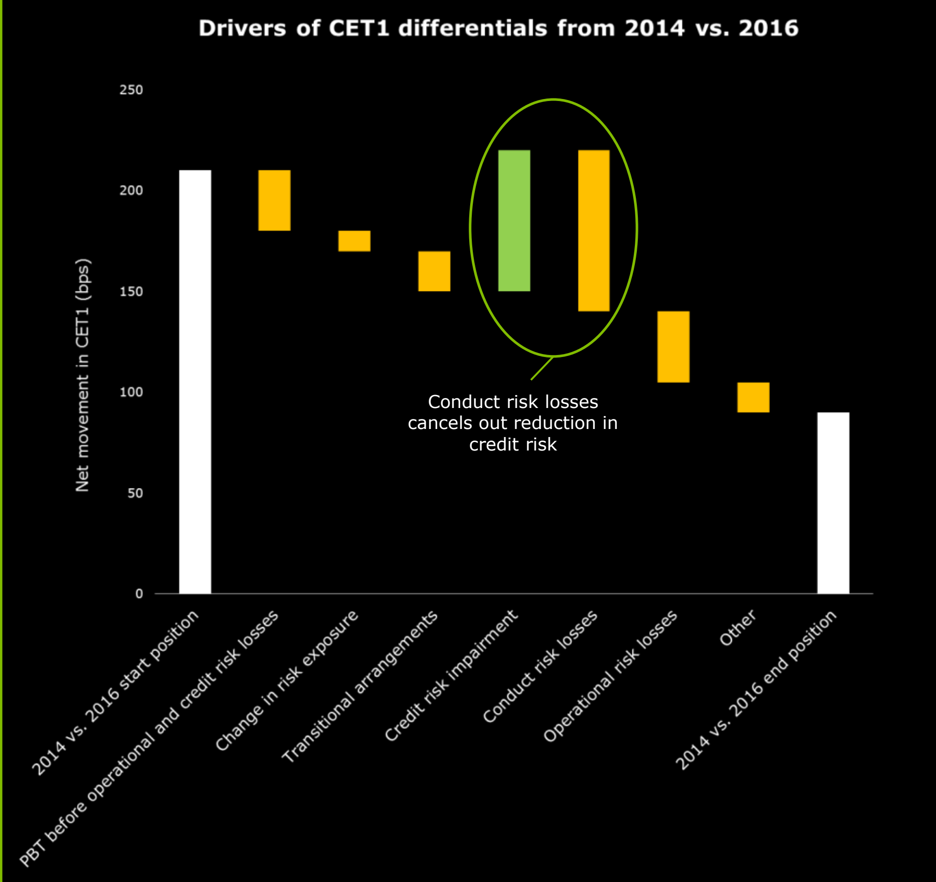
Despite the improvement in credit quality, credit risk losses contribute 57% of the downward movement in CET1.



- The impact on CET1 from credit risk losses over the time horizon of the stress test has decreased from 440bps in 2014 to 370bps in 2016.
- However, credit risk impairment still accounts for the biggest impact, dwarfing both market and conduct risk losses.
- Credit risk is expected to be the focus of regulatory stress testing going forward. However, other risk types are growing in prevalence.

3. New conduct risk methodology requires careful interpretation

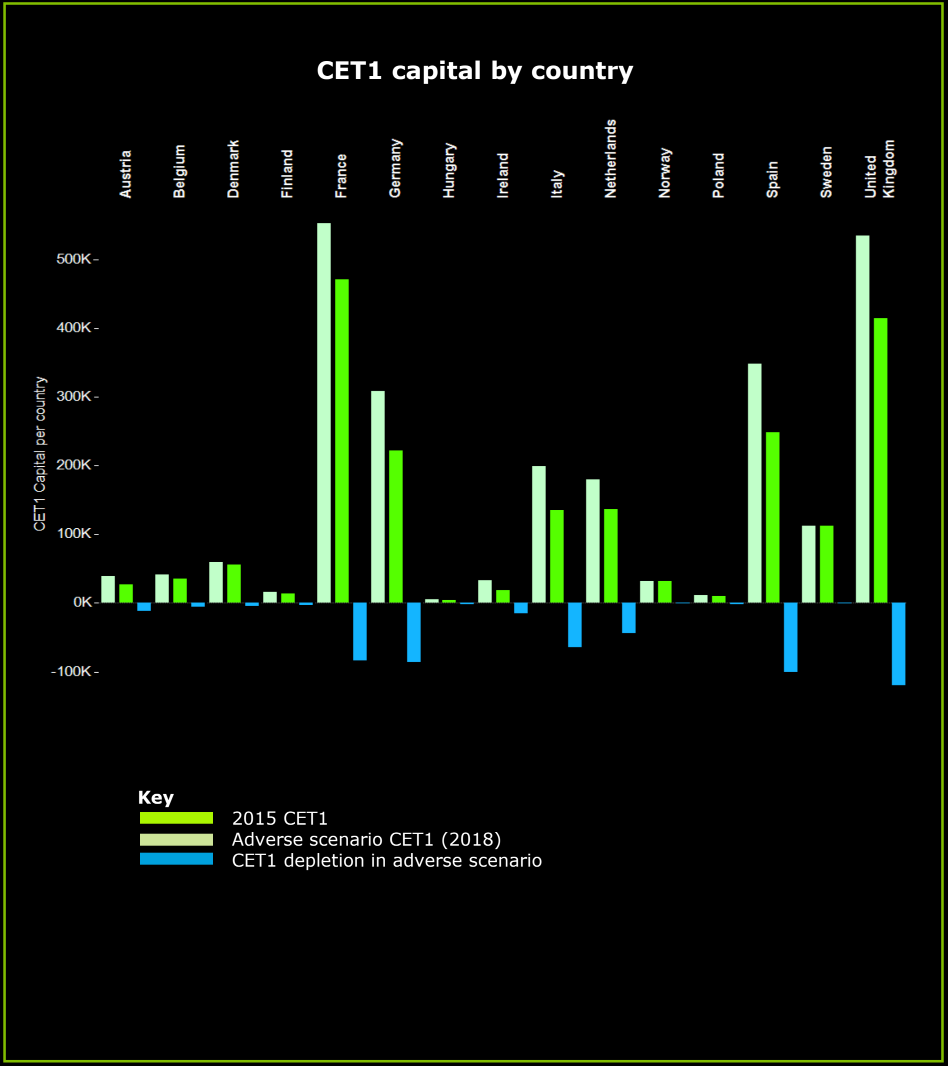
New conduct risk methodology resulted in additional €71bn losses which more than offset the credit quality improvements since 2014.



- The EBA also disclosed aggregated conduct losses of €71bn (80bps impact on CET1) which are more idiosyncratic in nature and not necessarily correlated to macroeconomic events.
- No details were released by bank or geography, however, the estimated impact seems to be driven by historical penalties (UK, France and Netherlands).
- Excluding conduct losses, the CET1 impact from peak to trough, when compared to the 2014 exercise, would decrease from 340bps to 260bps.
- The EBA did not disclose conduct losses for the 2014 exercise and did not require banks to follow a set methodology.
- Assuming such losses were negligible, the new methodology more than offset the credit quality improvements since 2014 (70bps less in 2016).

4. Focus now moves to Pillar 2

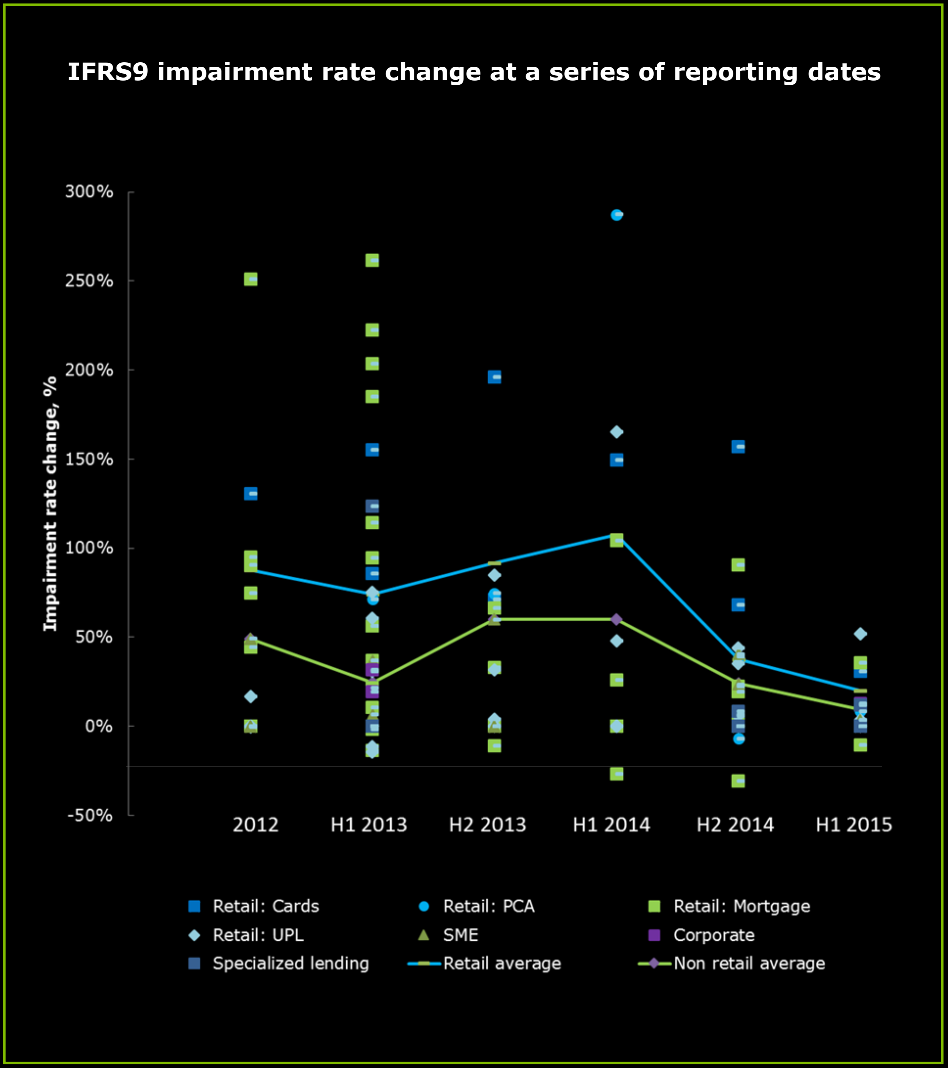
SREP guidance expected to focus on this as well as level of capital depletion during the forecast horizon and qualitative aspects.



- Key supervisory response expected in the form of Pillar 2 Requirements and Guidance (P2R & P2G).
- The EBA refrained from challenging banks publicly on qualitative issues, but further scrutiny may well now come.
- We expect supervisors to consider key qualitative challenges – such as data quality and governance – which have come to the fore in running the exercise.
- We expect the level of qualitative challenge to grow when the exercise is run in 2018, similar to the trend being seen in the evolution of supervisory stress testing exercises in the UK and US.

5. IFRS9 will create additional credit risk challenges

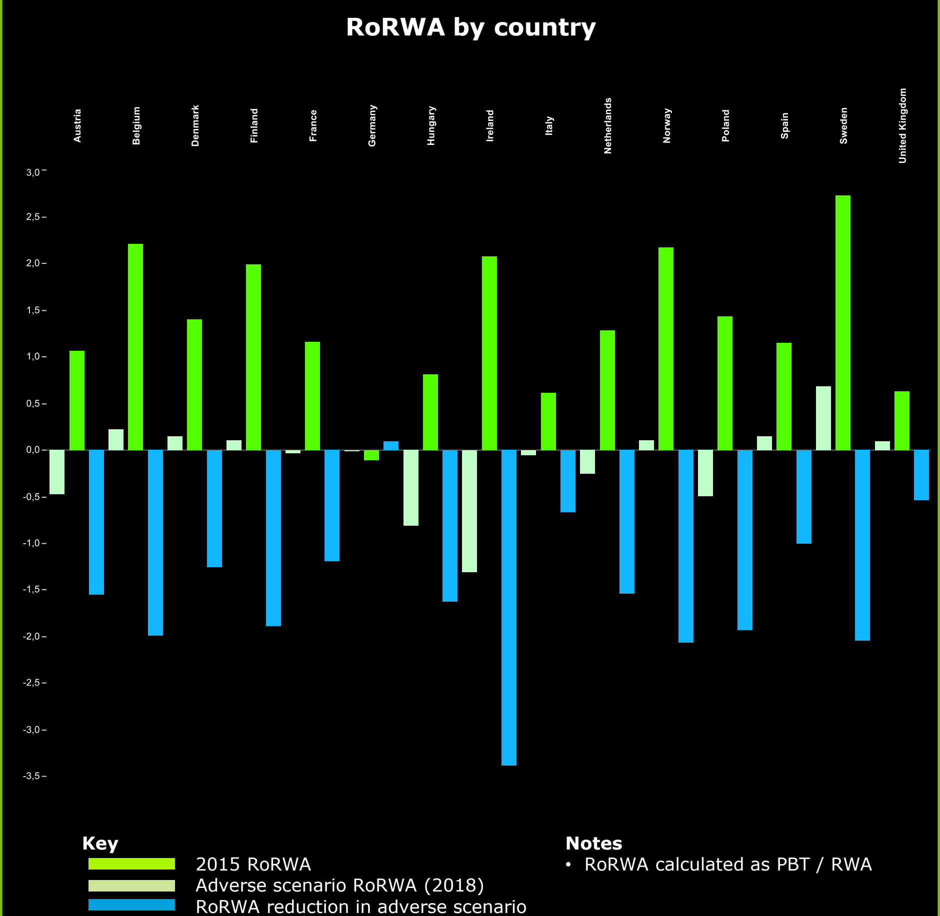
Introduction of IFRS9 in 2018 will likely lead to more intensive data challenges and ultimately to greater stress loss volatility amongst participating banks.



- IFRS9 will introduce a new method of impairment accounting, moving from an incurred loss model to an expected loss model.
- Credit risk data requirements are the largest component of the EBA template and will likely increase in 2018 with the onset of IFRS9.
- Assets that have significantly deteriorated (Stage 2) will be subject to a lifetime expected loss. Additionally, IFRS 9 could lead to cliff effects and pro-cyclicality which would result in significant increases to impairment under stress.
- The Deloitte Quantitative Impact Study highlights the level of variability amongst participating banks (see graph).
- According to the Deloitte Global IFRS9 Banking survey, 70% of respondents anticipated a reduction up to 50bps in CET1 ratio due to IFRS9. The vast majority did not know how their regulators will incorporate IFRS9 into regulatory capital estimates.

6. Stress testing highlights industry-wide issue of returns

Increased standards in stress testing exercises likely to lead to lower stressed returns and may reduce the attractiveness of the industry.



- More than half of the countries recorded negative RoRWAs in the 2018 adverse scenario and of those recording positive returns, only Sweden was >0.5%.
- The biggest fall and weakest returns were observed in Ireland.
- Looking forward, banks' stressed returns will be negatively impacted by both sides of the RoRWA equation.
- Upcoming regulatory requirements are likely to increase the amount of capital banks need to hold and IFRS9 will make profitability more volatile in stress.
- Higher regulatory standards are also likely to compound historic issues impacting the attractiveness of the industry.
- The impact will be two-fold: i) costs required to run exercises will increase in parallel with regulatory standards; and ii) the outcomes will highlight a continuation of depressed returns in the industry.

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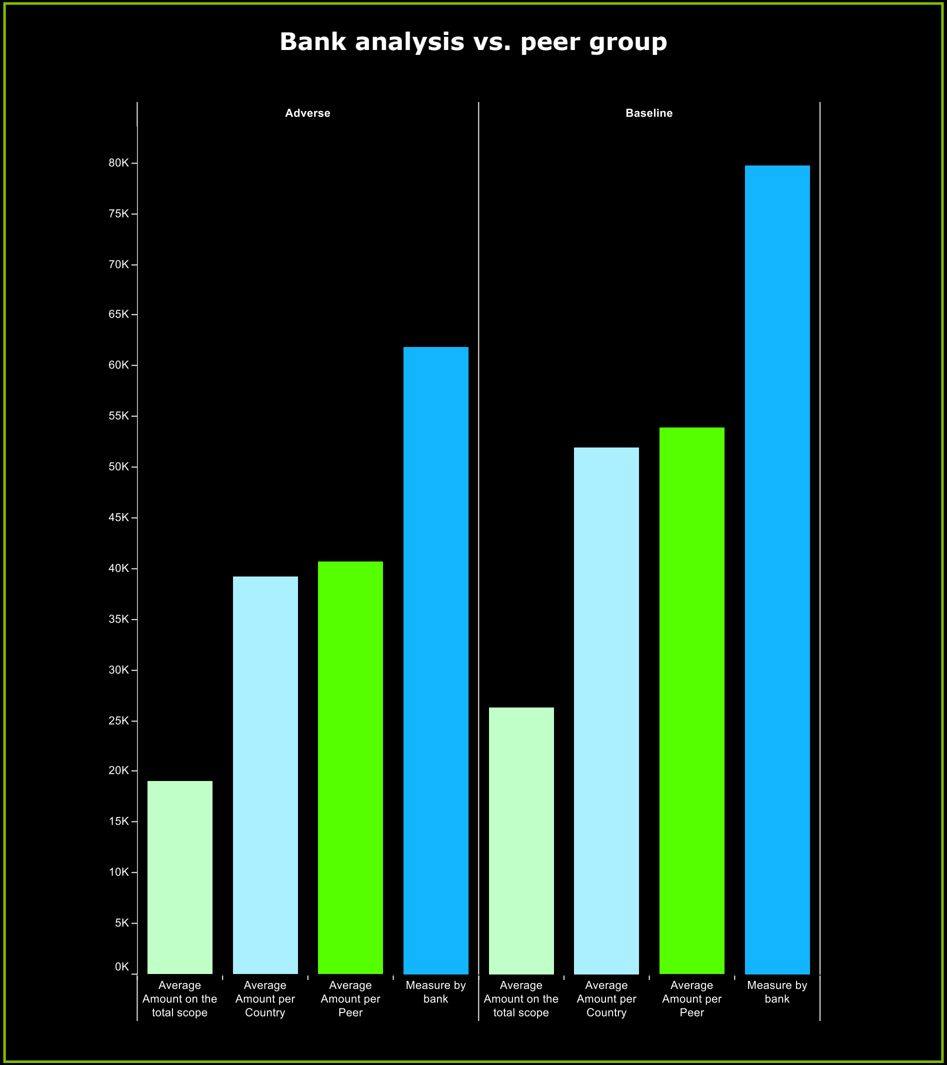
Using the Tool

We have created an interactive dashboard in Tableau so you can easily compare your bank to your peers.



- We have developed an interactive tool that analyses key relationships between the data published by the EBA.
- We have used the tool to undertake our own analysis and conclude the key takeaways.
- Click on the link on the covering email to access the tool.
- The dashboard allows direct access to the data behind each graph using the download functionality at the bottom right of the screen.
- The tool has been developed to provide greater and more accessible understanding of the results provided by the EBA.
- Some elements may not be displayed due to lack of information in the database.
- All information presented is based on data provided by the EBA following the 2016 stress testing exercise.

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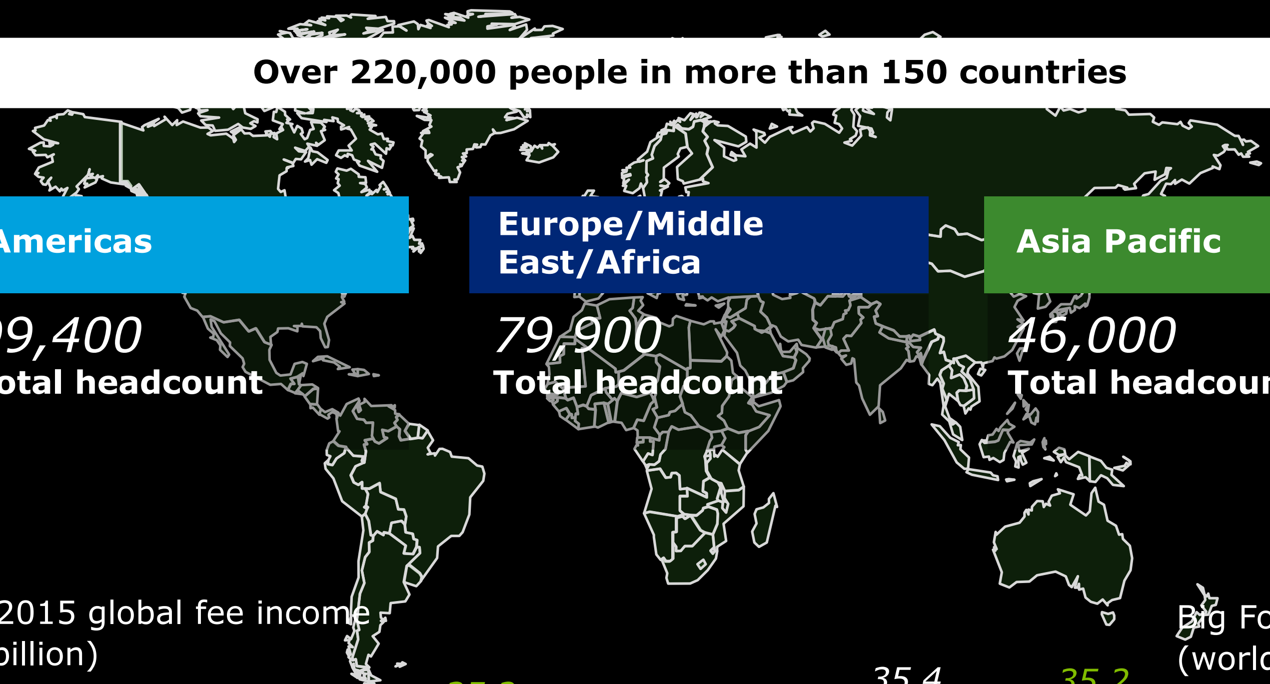
We are a global professional services leader and stress testing support is a core business provided by our risk advisory group.



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Americas

99,400
Total headcount

Europe/Middle East/Africa

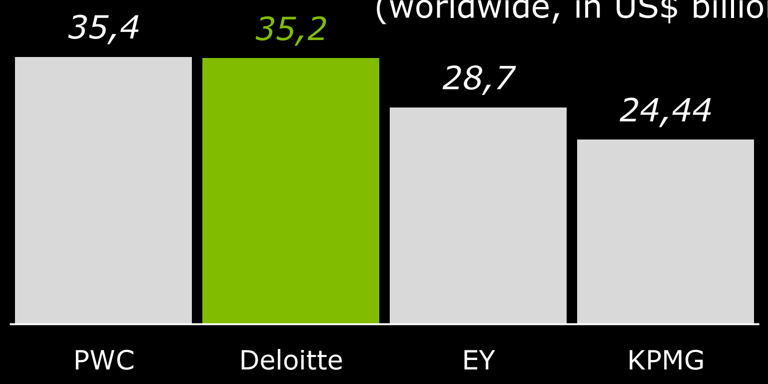
79,900
Total headcount

Asia Pacific

46,000
Total headcount

Deloitte 2015 global fee income (in US$ billion)

Big Four 2015 revenues (worldwide, in US$ billion)



Strong commitment to stress testing

Our highly qualified stress testing team has a global reach and contributes to specialised centres of excellence.

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Our people demonstrate the industry experience and eminence that our Deloitte teams bring, along with the robust, clear and insightful way it operates. The Deloitte EMEA quantitative modelling group brings together our most experienced resources across the network.

THOUGHT LEADERSHIP

Deloitte has been a prominent contributor in stress testing, gaining and disseminating extensive insight in recent years. Hot topics include the conduct of regulatory exercises, and the Single Supervisory Mechanism.

REGULATORY CENTRES OF EXCELLENCE

Our Banking Union Centre in Frankfurt (BUCF) brings together a multidisciplinary team of senior and experienced professionals from its financial services practices across Europe. Our EMEA Centre for Regulatory Strategy (ECRS) is a leading authority on regulatory methodology, providing clients with an insightful view of the regulatory landscape and supervisory expectations.

GLOBAL NETWORK

We have a global network of highly-qualified and dedicated professionals, with deep knowledge of PRA, ECB, EBA and Fed stress testing.

Focus on regulatory strategy

We have a dedicated EMEA-wide centre that provides our clients with an insightful view of the regulatory landscape.

Dedicated team

Dedicated team to monitor and analyse key emerging regulatory developments.

Regulatory News

Monthly thematic round-up of significant developments, as well as regular briefing notes and papers on key regulatory developments.

Strategic focus

Strategic view to our clients on the potential outcomes of major structural and strategic changes resulting from regulation.

Talented professionals

Highly talented professionals who are leaders in understanding and advising on the strategic impact of regulation.

Regulatory relationships

Maintain strong relationships with regulators, central banks, standard setters, finance ministries and major industry trade bodies.

Practical insight

Provide practical challenge and insight to Deloitte clients and project teams.

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