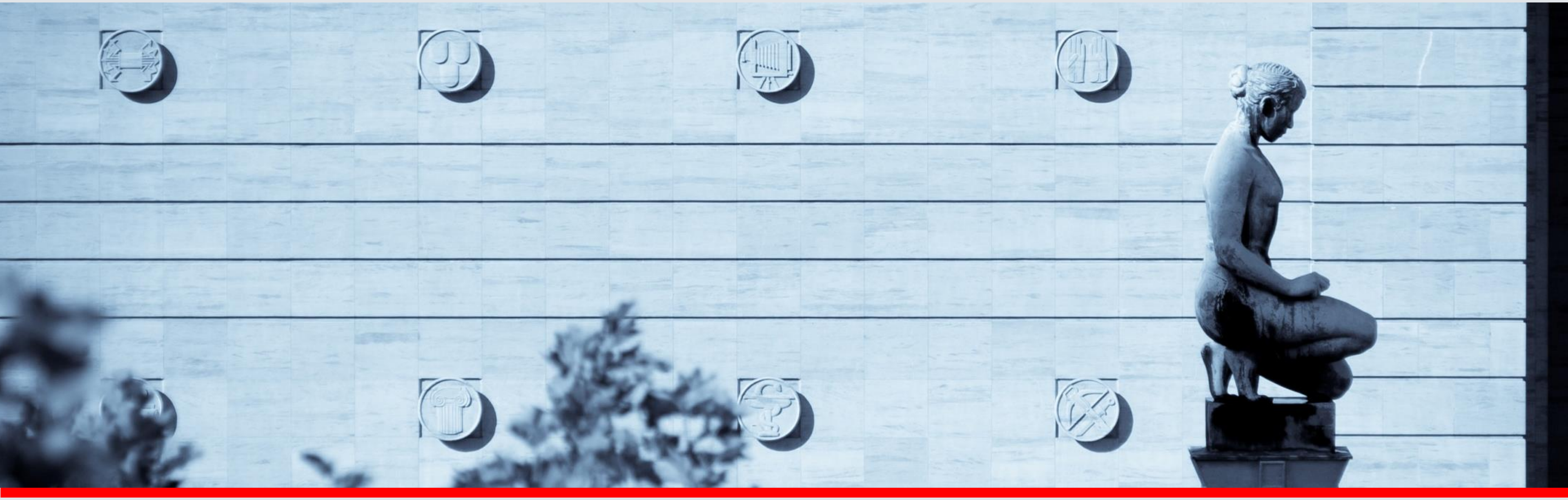
Comprehensive Assessment
Belgian banks results

October 26th 2014



National Bank
OF BELGIUM
Eurosystem

Agenda

- ► **Introduction**
- ► Methodology
- ► Process and organization
- ► Results
- ► Conclusions

Before ECB takes over its new supervisory role, a "Comprehensive Assessment" was granted in the SSM regulation

> *From the entry into force of this Regulation, in view of the assumption of its tasks, the ECB may require the competent authorities of the participating Member States and the persons referred to in Article 9 to provide all relevant information for the* ***ECB to carry out a comprehensive assessment, including a balance-sheet assessment, of the credit institutions of the participating Member State.***

Council Regulation (EU), conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions

Comprehensive Assessment is a prudential exercise composed of an Asset Quality Review and a Stress Test

The ECB together with the national competent authorities is carrying out a comprehensive assessment on major European banking groups, in line with the provisions regarding the Single Supervisory Mechanism which will become operational in November 2014

Main objectives of the exercise

The assessment is an important step in preparing the single supervisory mechanism and towards bringing about greater transparency of banks' balance sheets and consistency of supervisory practices within Europe

1. **Transparency:** Enhancing the quality of information available on the condition of banks
2. **Repair:** Identifying and implementing any necessary corrective action
3. **Confidence building:** Assuring all stakeholders that banks are fundamentally sound and trustworthy

Work blocks

The comprehensive assessment consists of two closely interlinked components

A. **Asset Quality Review:** Enhancement of the transparency of bank exposures by reviewing the quality of banks' assets, including the adequacy of asset and collateral valuation and related provisions

B. **Stress test:** Forward-looking picture of the resilience of banks' balance sheets to stress scenarios (in co-operation with the EBA). Incorporation of AQR findings via join-up process.

Source: "Note on Comprehensive assessment", ECB, October 2013

A capital plan will be required for banks that fail the Comprehensive Assessment exercise

- Outcomes of the Comprehensive Assessment are CET1 ratios following the Asset Quality Review and the Stress Test projections

- The following CET1 ratio thresholds have been defined by the ECB to assess the outcome of the Comprehensive Assessment:
  - AQR-adjusted 2013 CET1 ratio: **8.0%**
  - Baseline projection of CET1 ratio[1]: **8.0%**
  - Adverse projection of CET1 ratio[1]: **5.5%**

- Banks displaying a capital shortfall against those thresholds will be required to present a **capital plan** within 2 weeks

- **Capital measures** taken by the banks between January 1st 2014 and September 30th 2014 are not taken into account in the Comprehensive Assessment outcome
  - Impact of those measures is disclosed as part of disclosure templates
  - If sufficient to cover the capital shortfall, those measures can constitute the capital plan
  - Capital measures such as asset sales are not part of disclosure templates but can be included in the capital plans

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[1] Lowest CET1 ratio over the stress test horizon (2014-2016)

Six Belgian banks were in scope for the Comprehensive Assessment

- **Comprehensive Assessment performed by the NBB on six home banks**
  - Investar (holding of Argenta Bank- Verzekeringsgroep)
  - Axa Bank Europe SA
  - Belfius Banque SA
  - The Bank of New York Mellon SA
  - Dexia NV
  - KBC Group NV

- **In addition, NBB supported the Asset Quality Review on two host banks (exercise led by home authorities)**
  - BNP Paribas Fortis (home authority: ACPR)
  - ING Belgium (home authority: DNB)

Methodology

The AQR comprised three phases with final report disclosure in October 2014 constituting the end point

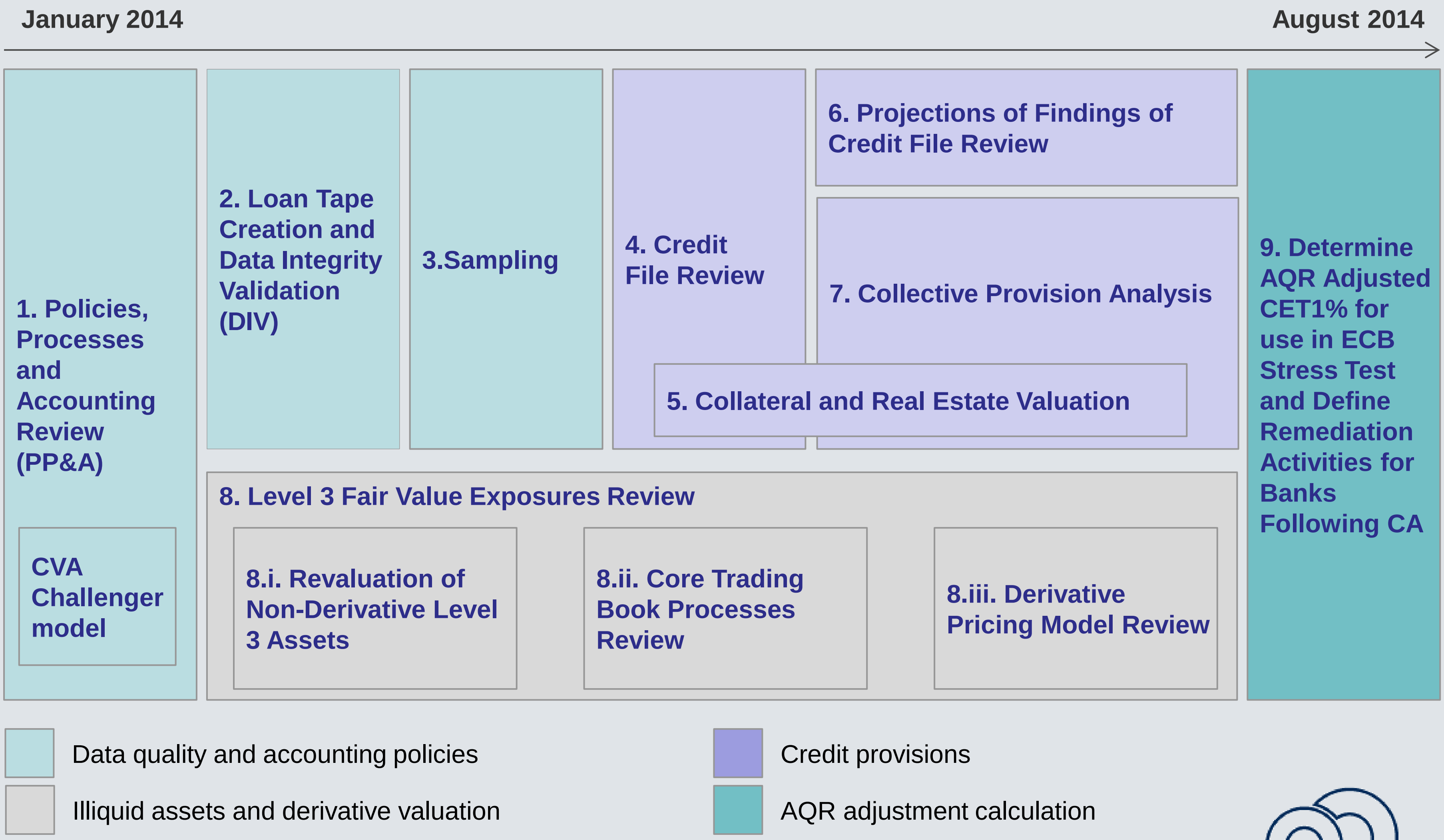
- **Phase 1: A Risk-based portfolio selection**
  - Based on a NBB bottom-up proposal based on risk assessment (50% of credit risk-weighted assets covered by portfolio selection)
  - Final selection performed by the ECB following discussion with NBB

- **Phase 2: Performance of an Asset Quality Review**
  - 9 work-blocks covering credit portfolio and fair value assets (see next page)
  - Prudential exercise relying on conservatism beyond accounting rules
  - Continuous Quality Assurance process

- **Phase 3: Final report and disclosure**
  - Calculation of AQR-adjusted CET1 ratio and other input for stress test (join-up process)
  - Final report under the form of a letter to bank's management comprising detailed AQR findings and associated remedial actions
  - No direct transposition of quantitative findings in financial accounts

Source: ECB Note on the Comprehensive Assessment, October 2013

The ECB designed a prescriptive AQR methodology based on 9 work blocks covering banking and trading books



January 2014

August 2014

1. Policies, Processes and Accounting Review (PP&A)

CVA Challenger model

2. Loan Tape Creation and Data Integrity Validation (DIV)

3.Sampling

4. Credit File Review

5. Collateral and Real Estate Valuation

6. Projections of Findings of Credit File Review

7. Collective Provision Analysis

8. Level 3 Fair Value Exposures Review

8.i. Revaluation of Non-Derivative Level 3 Assets

8.ii. Core Trading Book Processes Review

8.iii. Derivative Pricing Model Review

9. Determine AQR Adjusted CET1% for use in ECB Stress Test and Define Remediation Activities for Banks Following CA

🟦 Data quality and accounting policies

⬜ Illiquid assets and derivative valuation

🟪 Credit provisions

🟩 AQR adjustment calculation

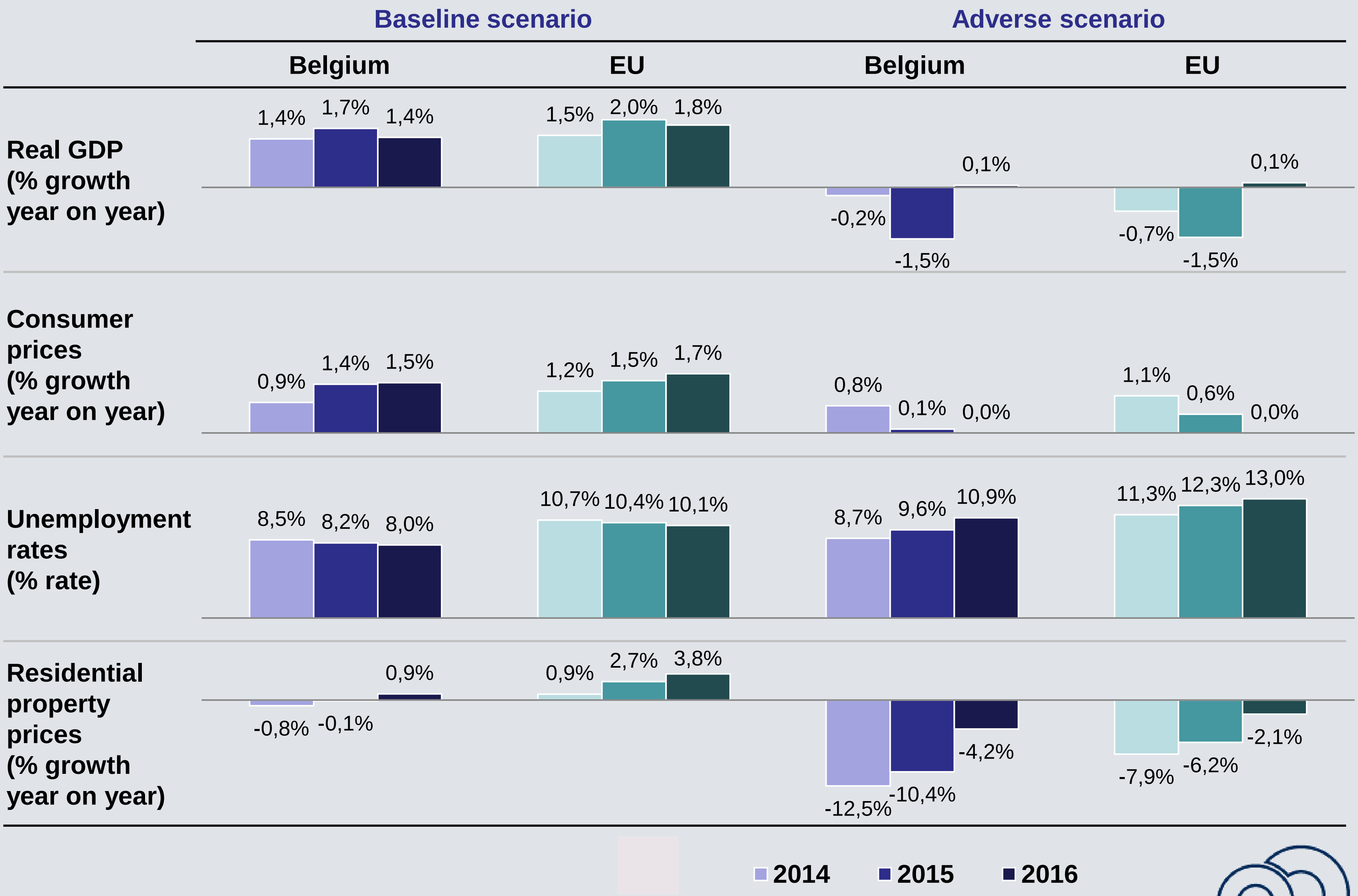
The stress test relied on a shock applied across various risk areas under a static balance sheet assumption

Risk	Main stress principle
General assumption	• Static balance sheet unless restructuring plan approved by EC before end 2013 (applicable for Dexia, KBC, Belfius)
Credit risk	• Stressed credit risk parameters
Market risk	• Market crisis scenarios applied on trading book positions • Default of largest counterparty
Securitization risk	• Stressed credit risk parameters for banking book positions • Market crisis scenario for securitization positions
Sovereign risk	• Haircuts applied to sovereign exposures
Cost of funding and interest income	• Increase in funding costs • Limited pass-through to clients • No interest on non-performing loans
Others	• Constraints applied on other P&L items (cap/floors at 2013 levels) • Basel III transition

P&L and other capital impact

RWA impact

Comparison of macroeconomic scenarios between Belgium and European Union average



Source: EBA Stress Test macroeconomic scenario

Process and organization

A robust quality assurance process has been set up to ensure the highest quality of deliverables

Asset Quality Review

- AQR methodology and **technical assistance** has been provided by the ECB
- AQR has been executed by **external auditors** specifically hired for this exercise, which have performed a **first layer of Quality Assurance** by separated teams
- A **second layer of Quality Assurance** has been performed by the NBB
  - Weekly meetings with auditors and banks
  - Bi-weekly meetings with auditors
  - Cross-bank benchmarking of results
- A **third layer of Quality Assurance** has been performed by the ECB by transversal comparison across banks and countries

Stress Test

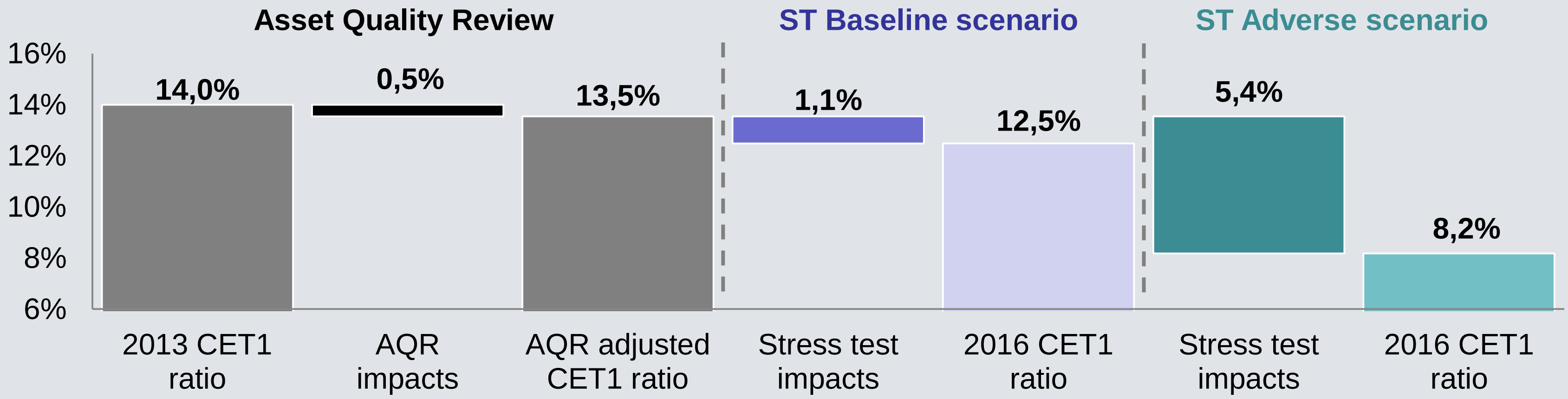
- Stress Test methodology has been provided by the EBA, with additional guidance and benchmark from the ECB
- Stress Test exercise has been **performed by the banks** with technical guidance from the NBB and the EBA
- A **first layer of Quality Assurance** has been performed by the NBB
  - Three meeting with banks organized before initial submission
  - Cross-bank benchmarking of results
- A **second layer of Quality Assurance** has been performed by the ECB
  - Automated Quality Assurance checks
  - Top-down benchmarking of results

Results

Overview of Comprehensive Assessment results for Belgian banks

Excluding Dexia, Belgian banks display an average decrease in CET1 ratio of 5.8% under adverse scenario

Average CET1 ratio for Belgian banks (excluding Dexia)



- AQR impact is **limited to 0.5%** and driven by the specific methodology, results confirm the correct application of accounting standards in Belgium
- Under the baseline scenario, the Belgian banking sector remains **well above the threshold** confirming the improvement of its financial position in recent years. The negative impact is **mainly due to repayment of state aid**
- In the adverse scenario, the Belgian banking sector remains on average above the threshold with a **comfortable capital buffer** remaining: no post-Comprehensive Assessment capital measures are needed

Source: Comprehensive Assessment disclosure templates, NBB calculations

The large degree of heterogeneity in results reflects different business models and progress in restructuring

			CET1% evolution *Baseline scenario*		CET1% evolution *Adverse scenario*		
	CET1% 2013	AQR Result[1]	Stress Test Result[2]	Final CET1%[3]	Stress Test Result[2]	Final CET1%[3]	Remedial measures taken
Argenta	24.3%	-0.2%	-4.1%bps	20.1%	-9.4%	14.7%	-
AXA Bank Europe	15.2%	-0.5%	-1.9%	12.7%	-11.3%	3.4%	Shortfall covered by T1 and AT1 capital issuance
Belfius	13.9%	-0.3%	-2.5%	11.0%	-6.2%	7.3%	-
BNYM	14.9%	-0.0%	+0.1%	14.9%	-3.6%	11.2%	-
KBC	13.3%	-0.6%	-0.7%	12.0%	-4.4%	8.3%	-
Weighted average (excl. Dexia)	14.0%	-0.5%	-1.1%	12.5%	-5.4%	8.2%	-
Dexia	16.4%	-0.6%	-5%	10.8%	-10.9%	5.0%	Given ORP[5] which benefits from a State guarantee , no need for capital raising

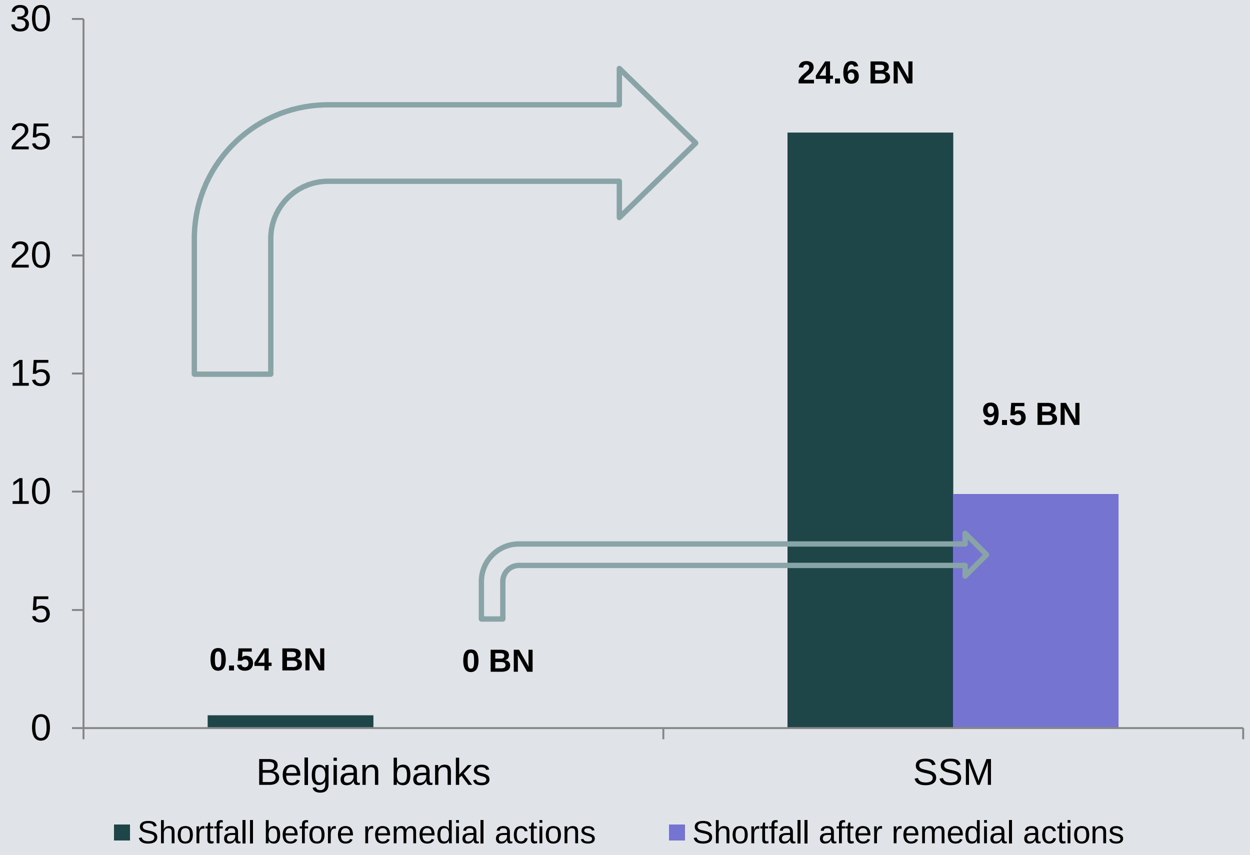
🟦 Result below ECB threshold (Baseline: 8% - Adverse: 5.5%)

Source: Comprehensive Assessment disclosure templates, NBB calculations

1. Net of taxes; 2. Including join-up impact; 3. Lowest end-of-year CET1% over the stress test horizon (for all banks and Belgium: 2016, except BNYM and KBC: 2014); 4. Capital measures taken between 01/01/2014 and 30/09/2014 (issuance/Repayment of CET1 instruments, issuance/repayment of Additional Tier 1 instruments); 5. Orderly Resolution Plan

Belgian banks represent 2% of total SSM capital shortfalls identified by the Comprehensive Assessment

Total capital shortfalls identified by the Comprehensive Assessment



Source: ECB Comprehensive Assessment report

Two Belgian banks failed to meet adverse threshold but required capital measures have already been taken

- **In adverse scenario, total capital shortfall in Belgium amounts to 0.54 BN EUR out of 25.2 BN EUR in the SSM** due to Axa Bank Europe (200 M EUR shortfall) and Dexia (339 M EUR shortfall)

- **Axa Bank Europe** (ABE) was especially vulnerable to EBA assumptions due to Hungarian credit portfolio which is in run-off and structural low profitability from other activities in recent years
  - ABE has already taken the required capital measures: Issuance of T1 and AT1 capital for 225 M EUR before September 30th 2014
  - In addition, significant de-risking and cost-cutting performed since beginning of 2014

- **Dexia** has been subject to the full exercise. ECB has recognised Dexia's specificities and considers no capital measures beyond approved Orderly Resolution Plan (ORP)
  - Given the funding state guarantee, which allows the Group to hold assets until maturity, the negative impact of the losses sovereign bond portfolio is disregarded leading to a 2016 CET1 ratio of 7.6%
  - In addition, Dexia sold assets since end 2013, which would have improved further the solvency ratio by around 0.3% CET1
  - Therefore, the ORP of Dexia is not called into question

Results

Asset Quality Review

The AQR results in an average adjustment of 2013 CET1 ratio by 0.45%, driven by the application of a conservative methodology

AQR work-blocks	Average CET1% adjustment for Belgian banks
Credit portfolio	**0.34%**
Individually assessed provisions	*0.12%*
Collectively assessed provisions	*0.22%*
Trading portfolio	**0.20%**
Credit value adjustment on derivatives (CVA)	*0.15%*
Illiquid assets (level 3 exposures)	*0.05%*
Pre-tax AQR adjustment to 2013 CET1%	**0.54%**
Post-tax AQR adjustment to 2013 CET1%	**0.45%**

AQR has demonstrated accounting practices of Belgian banks are generally conservative and in line with accounting standards

Source: Comprehensive Assessment disclosure templates, NBB calculations
Note: post-tax AQR adjustment including Dexia is 0,48%

Beyond quantitative impacts, the AQR highlighted some qualitative shortcomings in banks’ practices

Main topics	Areas for improvement
1 Data quality	• Available information on collateral and credit profile of clients • Reconciliation of data sources • Correctness of assets classification and portfolio
2 Credit risk	• Implementation of non-performing loans and forbearance identification standards • Collateral management practices • Documentation of provisioning model key parameters
3 Market risk	• CVA calculation

Results

Stress Test

Even excluding Dexia, legacy activities represent about 30% of impact on Belgian banks under adverse scenario

	CET1% impact under adverse scenario (excluding AQR)
2013 CET1 ratio	**14.0%**
State Aid repayments[1]	*-1.1%*
Divested/Run-off activities[2]	*-0.6%*
Total legacy impacts	**-1.8%**
Credit portfolio – Belgium exposures	*-2.2%*
Credit portfolio – foreign exposures	*-2.5%*
Market activities	*-1.3%*
Securitization portfolio	*-0.2%*
Sovereign portfolio	*-0.8%*
Profit generation (net interest income and other P&L)	*+4.0%*
Other CET1 and RWA impacts	*-0.6%*
Total non-legacy impacts	**-3.7%**
2016 CET1 ratio	**8.6%**

- 5.4%

Source: stress test templates, NBB calculations

1. State Aid repayments includes KBC repayments of YESs (Yield Enhanced Securities). 2. Divested activities includes: Belfius AFS, ABE structure portfolio and ABE Hungarian loan book

Note: figures excluding Dexia

The Stress test results reflect the general characteristics and the business models of Belgian banking sector

Main topics		Stress test highlights
1	**Legacy items**	• Severe impact from shock applied to portfolios that are in run-off or already sold • Incorporation of full state aid repayment by KBC (1.8 BN EUR)
2	**Credit portfolio**	• Main driver of results, given Belgian banks' focus on real estate credit activities and significant foreign credit portfolios
3	**Market activities**	• Limited trading activities of Belgian banks • Impact driven by counterparty credit risk, including CVA and default of largest counterparty
4	**Sovereign portfolio**	• Impact driven by large sovereign portfolio holdings (47% on Belgium) • Gradual removal of prudential filters taken into account
5	**Profit generation**	• Sector level baseline profitability comparable to EU peers although heterogeneities are observed • Significant impact from shock assumptions on retail funding cost reflecting banks business models relying in savings deposits

Results

Comparison with SSM results

High-level comparison with average SSM results has been performed but should be considered with appropriate care

- Given that ING Belgium and BNPP Fortis are consolidated within their mother companies, average results for the six Belgian banks presented in the subsequent slides **should not be considered as “Belgium results”**

- Average (SSM or Belgian) results cover a **very heterogeneous reality**; individual results should be best analyzed in the light of smaller peer group comparisons with similar business models

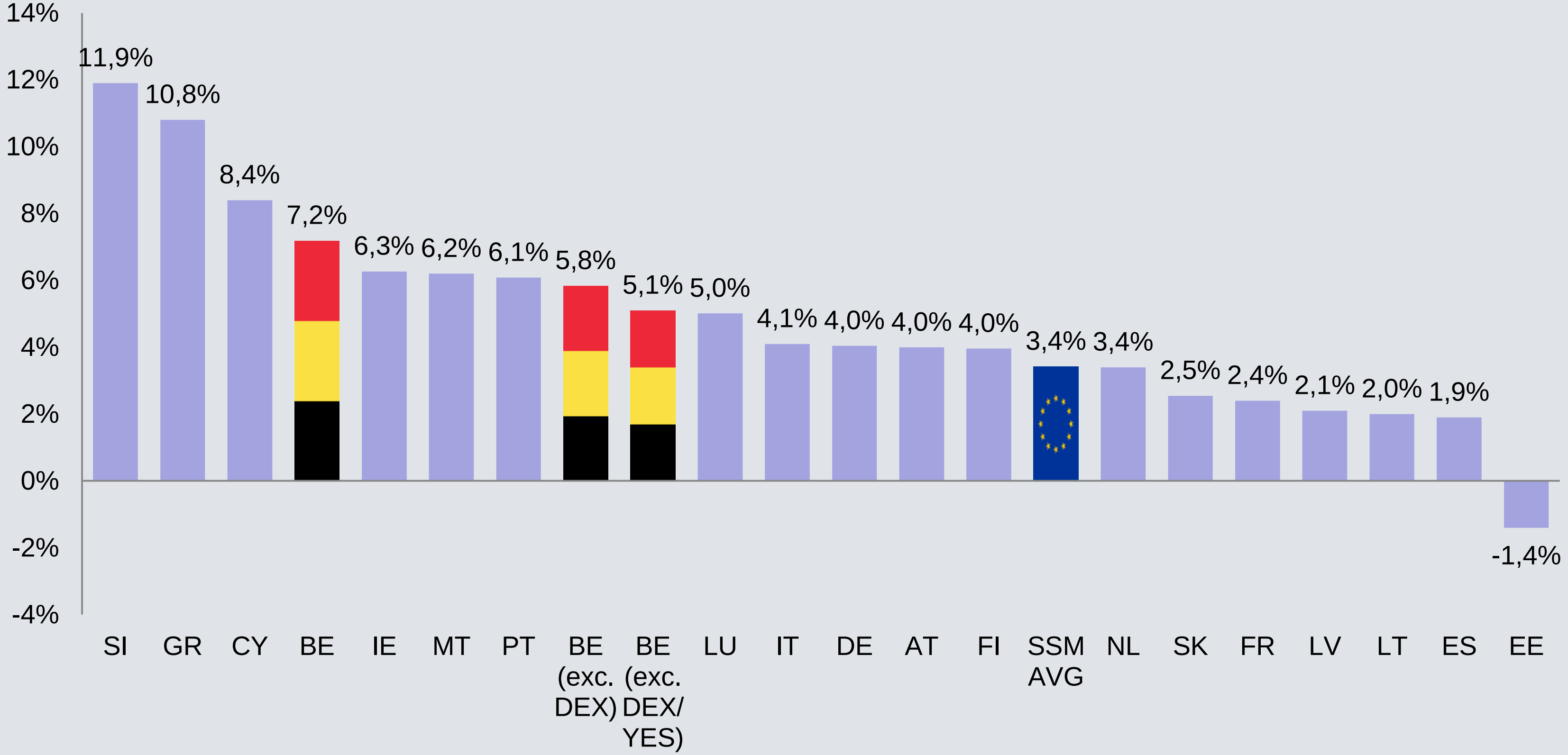
- Limited data on results at SSM level prior to October 26th **prevented from tailoring analysis** to the Belgian banks specificities

- Consequently, **this presentation only provides an high-level positioning of Belgian banks’ Comprehensive Assessment results**

Belgian average reduction in CET1 ratio under adverse scenario is significantly higher than SSM average…

Reduction in CET1 ratio for SSM countries under the adverse scenario in 2016

Weighted average, NBB estimates



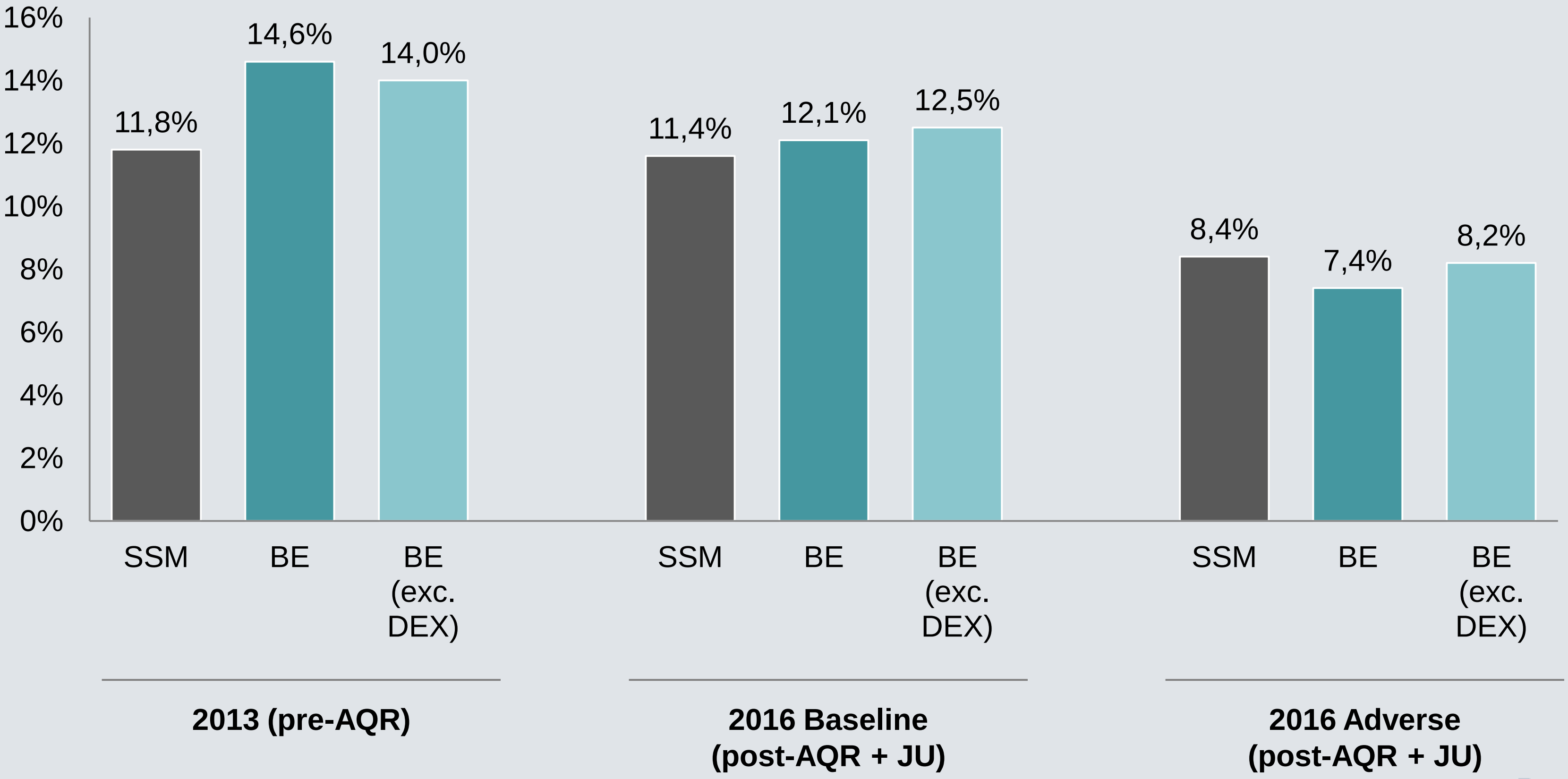
Source: ECB Comprehensive Assessment report, NBB calculations

Note: Exc. DEX = excluding Dexia, exc. YES = excluding repayment of KBC YESs

… but Belgian average CET1 ratio projected for 2016 remains in line with SSM average under both scenarios

Average CET1 ratio for SSM countries and Belgium

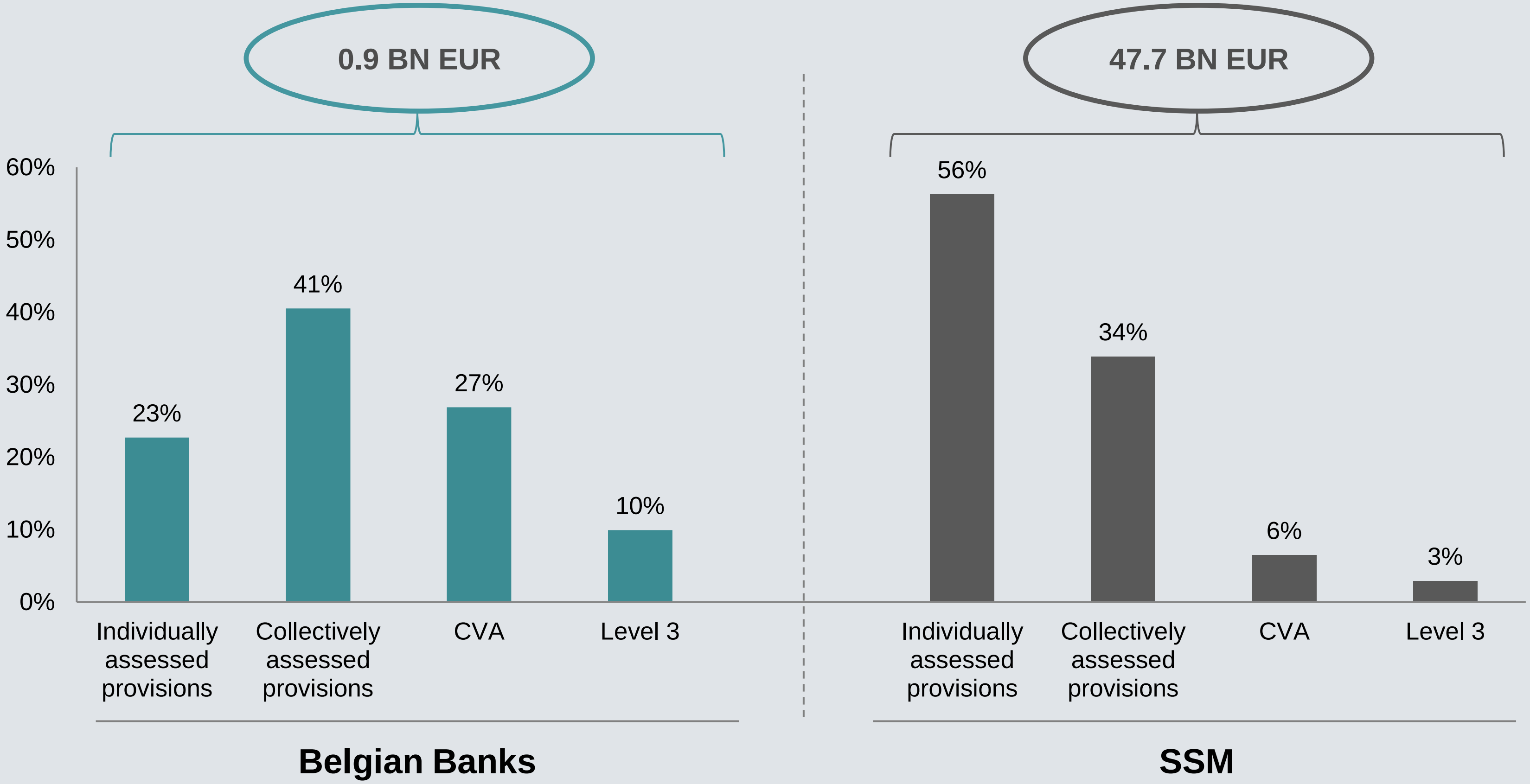
Weighted average



Source: ECB aggregate report, NBB calculation

In spite of different drivers, Belgium and SSM report a similar average AQR impact

Pre-tax impact of the AQR by component,
In % of total AQR impact, excluding Dexia for Belgium



Source: AQR templates, ECB Comprehensive Assessment report, NBB calculations

Differences between SSM and Belgium average in the CA results are mainly driven by legacy and business model specificities

- Under stress test scenarios, Belgium banks are, on average, more severely impacted than SSM average
  - Significant impact from **legacy activities** on Belgian (repayment of State Aid, run-off and divested portfolios)
  - Belgium banks **limited trading results and fee and commission income** are insufficient to offset losses due to market risk assumptions on counterparty credit risk
  - **Large holdings of sovereign bonds** driven by excess liquidity result in substantial increase in RWA and significant valuation losses under stress assumptions
  - **Relatively healthier credit portfolio**, in line with AQR findings, leads to:
    - Larger than average increase in RWA due to Belgian real estate prices shock
    - Lower than average contribution to stressed impairment levels

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On average, Belgium banks have a solvency position in line with SSM banks at the end of Comprehensive Assessment exercise

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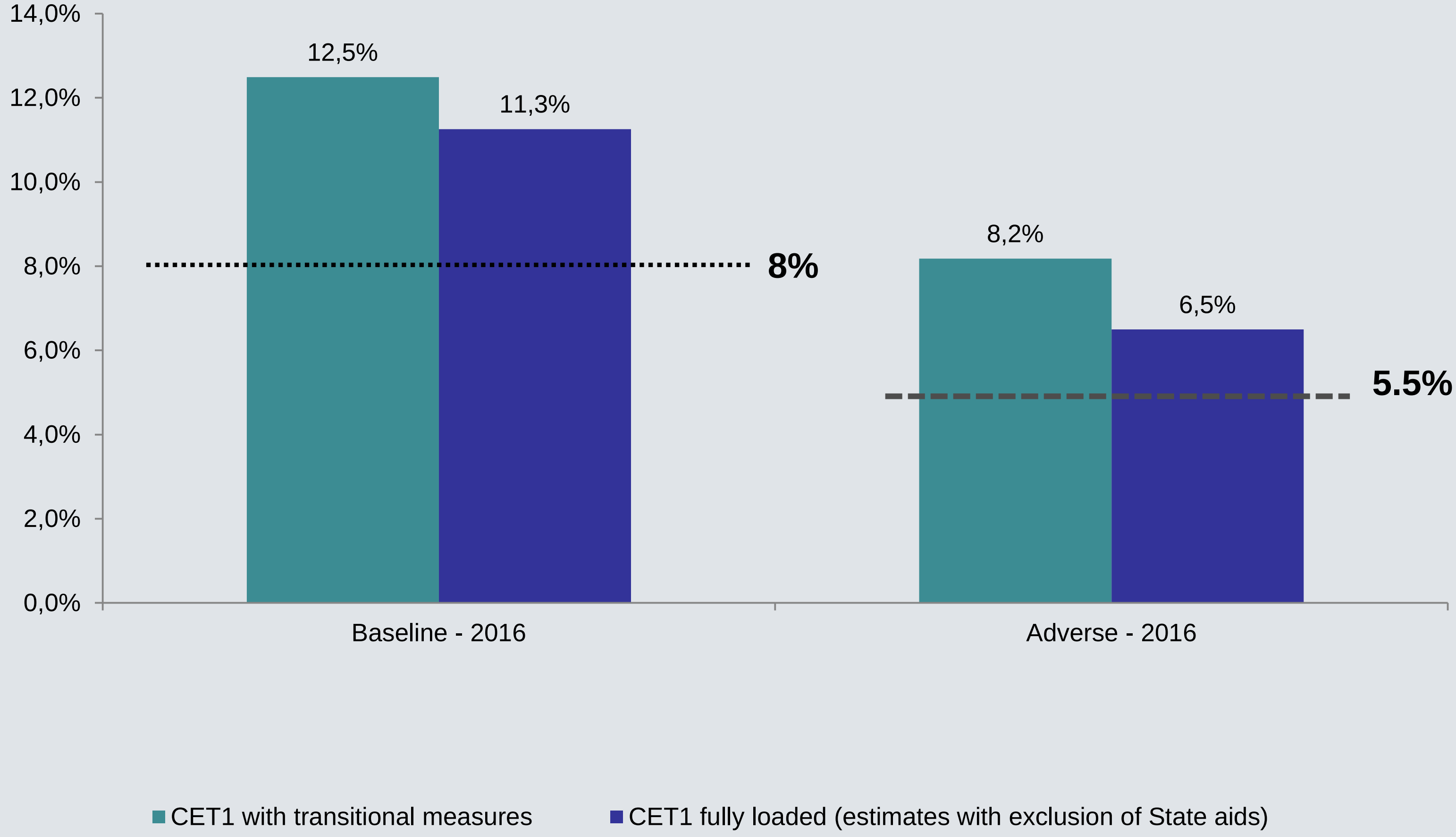
Belgian banks are already above the 5,5% threshold under fully-loaded CET1 definition even after stress conditions



Source: stress test templates, NBB calculations
Note: figures excluding Dexia

Conclusions

Conclusions

- The Comprehensive Assessment was a unique exercise by its scope and seriousness

- The NBB, the audit firms and the Belgian banks have worked hard together with the ECB to ensure credibility and transparency of the whole exercise. Beyond heterogeneity among banks and portfolios, the Comprehensive Assessment demonstrates that Belgian banks :
  - Comply with international accounting standards
  - Have a comfortable capital buffer in the baseline scenario
  - Would be resilient under a serious deterioration of economic conditions

- Belgian banks are already above the 5,5% threshold under fully-loaded CET1 definition even after stress conditions

- To realize sustainable profitability and enhance capital positions, restructuring and rationalization efforts have to be pursued

- The conclusion of Comprehensive Assessment is a key milestone in the start of the SSM and the banking union. It is an important exercise to bring back confidence in the European banking sector.

Additional information available

Source	Additional information available on respective website
NBB	• Press release • Press conference presentation
ECB	• Press release • Comprehensive Assessment disclosure templates • ECB Comprehensive Assessment aggregate report
EBA	• Press release • EBA disclosure templates
Banks	• Press release