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PRESS RELEASE

# Results of the Comprehensive Assessment of Belgian banks

## Objectives and components of the Comprehensive Assessment

Today, the ECB and the national supervisory authorities (including the NBB) will complete a large-scale exercise – the so-called Comprehensive Assessment or CA - which consists in a thorough assessment of the strengths and weaknesses of the major banks in the euro area. This exercise had a threefold objective: to increase transparency by improving the quality of the information available on the situation of banks, to put the banking system on a sounder basis by identifying and implementing the necessary measures to secure solvency, and, finally, to enhance confidence in European credit institutions. These conditions are essential to allow the sector to play its role in support of economic growth and to ensure the credibility of the new single supervisory mechanism, which aims to centralize the prudential supervision of banks at the ECB from 4 November 2014.

The assessment was based on two major complementary pillars: an asset quality review (AQR) and stress tests. These two major components were complemented by a "join-up" exercise designed to combine the results of the AQR with those of the stress tests, in order to ensure the overall consistency of the exercise. While the AQR mainly consisted of checking the assets valuation in the accounts of the institutions on 31 December 2013, the primary objective of the stress tests was to determine the capacity of credit institutions to absorb macroeconomic and financial shocks over a three-year time horizon. For the stress tests, two main scenarios were considered. The first, the so-called baseline scenario, is based on the European Commission's economic forecasts at the end of 2013 and already reflects rather difficult conditions for banks, given the poor forecasts for economic growth and certain shocks already included in this scenario. On the other hand, the second scenario, the so-called "adverse scenario", simulates a profound worsening of the economic situation, which by no means constitutes a prediction of future events. In this context, the results of this stress test must be considered as a prudential exercise. Furthermore, it does not take into account the possible reactions of banks, as it is based on a constant balance sheet assumption, in order to avoid that credit institutions, in order to pass the stress tests, take account of plans to expand or, on the contrary, to abandon activities.

In order to determine whether corrective measures must be implemented by the financial institutions subjected to the CA, a minimum solvency ratio, calculated in terms of core capital (Common Equity Tier 1 or CET1) was set at 8 pc for the asset quality review as well as for the baseline scenario of the stress test, and at 5.5 pc for the adverse scenario.

## Implementation of the Comprehensive Assessment

The exercise was conducted under the coordination of the ECB and on the basis of a harmonized methodology, with a view to promoting convergence in the definition of concepts and prudential rules and in supervisory practices. Despite this harmonization, cross-country comparisons should be made with caution since among others the CA allows to maintain some of the national discretions that are temporarily permitted by the European directives, especially for the definition of capital.

As a national supervisory authority, the NBB fully endorsed this exercise in order to help secure its success and ensured that the methodology was applied strictly. It also drew on the expertise of third parties, such as auditors or companies specializing in the valuation of assets, especially real estate. In total, about 400 people were involved in the conduct of the CA in Belgium, not to mention the own resources of the financial institutions mobilised for this exercise, which was very demanding in terms of data and documentation.

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Six Belgian institutions were subjected to the CA: Axa Bank Europe, Argenta, Belfius, Dexia, KBC Group and Bank of New York Mellon. Although Dexia is being progressively dismantled, it was subjected to the entire exercise. It has however not called into question the restructuring plan approved by the European Commission in 2012. It must also be noted that several banks, including BNP Paribas Fortis and ING Belgium, were subjected to the CA through their parent company.

**Results of the asset quality review (AQR)**

As part of the AQR, a very detailed analysis of assets has been conducted for 38 portfolios representing 51% of the weighted assets of the Belgian credit institutions which were subjected to the exercise. In each portfolio, a representative sample of the most risky credit files has been examined, i.e. in total more than 4200 credit files and nearly 3150 collaterals. In addition, 13 complex evaluation models were reviewed, as well as 96 illiquid securities amounting to 3,5 billion.

The asset quality review confirmed that the **accounting practices of Belgian banks are generally conservative and in line with international accounting standards,** which is reflected in particular in an adequate level of provisioning of the credit portfolios.

The adjustments required as a result of the AQR remained limited, amounting to 0.45%[1] of the CET1 ratio in Belgium. These adjustments were mainly caused by the conservative methodology of the exercise and did not call into question the accuracy of the annual accounts of the credit institutions. The AQR has nevertheless highlighted **some shortcomings, especially in terms of the data quality and the methodologies used to valuate assets and real estate collateral.** The Bank expects the Belgian institutions to address in the coming months the attention points identified by the AQR.

**Results of the stress tests (ST)**

*Baseline scenario*

**All credit institutions can cope with the baseline scenario.** The average CET1 ratio for Belgian banks would decline from 14% in 2013 to 12.5% at the end of 2016[2]. This is still significantly beyond the 8% threshold set by the harmonized methodology.

However, the overall results of the stress tests confirm the **considerable heterogeneity within the Belgian banking sector**, reflecting notably the differences in the business models of the banks and in the progress made in restructuring the activities following the financial crisis.

Besides a relatively low profitability of some banks, the decrease by 1,5% in the capital position of Belgian banks is mainly due to the repayment of the state aid by a bank. If this factor is excluded, the CET1 ratio would remain relatively stable and comparable to the rest of the euro area.

*Adverse scenario*

Also in the **adverse scenario, the average solvency position of Belgian banks, which would amount to 8.2% in 2016[3], would remain well above the minimum threshold of 5.5%.** The extremely depressed macroeconomic environment would result in a drop of 4.3% compared to the baseline scenario. As in baseline scenario, the level of CET1 ratio is partly influenced by the repayment of state aid. In the rest of the

[1] If Dexia² would be included, they would amount to 0,48%.

[2] If Dexia would be included, the average CET1 would decline from 14.6% in 2013 to 12.1% at the end of 2016.

[3] 7.4% if account is taken of the results of Dexia

euro area, the average decline between the two scenarios would represent 3,2%, which would render the solvency ratio comparable to the Belgian average.

In this scenario, the **worsening economic situation** would cause a significant increase in provisions and risk-weighted assets. The foreign activities of Belgian banks would be affected primarily, due to the underlying assumptions of the exercise and the rather large exposures of Belgian banks abroad. Besides, the stress test scenarios have also included the outbreak, in Belgium, of an housing crisis similar to the one seen in the recent years in some European countries, but without any comparison with the developments that have been seen in the past in Belgium.

**The activities inherited from the past** also influenced the results and the level of capitalization, all the more since one of the main assumptions of the stress tests was to freeze the banks' balance sheets at the level of December 31, 2013. While the exercise allowed to take account of the effect of the restructuring plans accepted by the EU, the other consolidation efforts which were continued in 2014 and that will continue in the years to come, were not allowed to be incorporated.

Furthermore, **the profitability constraint would negatively affect the results of some banks.** This would be particularly the case for Belgian banks, which have refocused in the recent years on their traditional intermediation activities, the profitability of which remains relatively low. These are mainly lending to the Belgian economy and investing in government bonds, mainly financed by Belgian savings, particularly collected under the form of regulated savings deposits. The stress tests have introduced stringent assumptions concerning the evolution of interest rate spreads and the value of government bonds. They anticipate in particular a significant increase in the cost of funding, due to a general rise in interest rates, while the possibilities to pass these increases through to the lending rates have been severely limited by the parameters of the exercise.

Comparisons between the results of Belgium and those of the euro area should be interpreted with caution, since the aggregate averages cover fairly diverse profiles. In addition, the results of two major banks with a strong presence in Belgium have not been included in the Belgian data, as they are consolidated at the level of their parent company. Overall it should be concluded that the Belgian banks – leaving aside the activities of the past - are more affected by factors reflecting in particular the restructurings undertaken following the crisis and some characteristics of their business model.

The write-downs and the increase in risk-weighted assets, with regard to public sector exposures, weighed more heavily on Belgian banks, especially given their larger holding of such assets. This large portfolio of government securities reflects the private sector savings surplus in Belgium, as well as a weak demand for credit, given the current economic environment. Furthermore, the low level of income, excluding interest margin, does not generally compensate for the losses provided for in the stress test. . In contrast, credit losses related to a deteriorating economic environment seem to affect the Belgian institutions in a more limited way, thus confirming the results of the AQR.

**Implications of the Comprehensive assessment for Belgian banks**

Two Belgian banks were particularly affected by the shocks included in the adverse scenario, namely AXA Bank Europe and Dexia. Both of them ended up with a capital position below the threshold of 5,5%.

After the end of December 2013, however, AXA Bank Europe continued to sell assets associated with non-core business activities, in order to reduce its risk profile, and raised capital. At this stage the bank meets the requirements set by the ECB and is no longer obliged to take any additional measures to strengthen its solvency position as a result of the Comprehensive Assessment.

As regards Dexia group, account has been taken of its specificities reflected in its restructuring plan of the Group approved by the European Commission. Thus, the inclusion in the own funds of unrealised losses on portfolios of sovereign bonds at market value was not considered relevant, given the state guarantees enjoyed by the group, that allow it to hold the underlying securities to maturity, even under deteriorating economic and financial conditions. If this factor is taken into account, the CET1 ratio of the group would amount to 7.6%, which is above the threshold of 5.5%. In addition, the Group has also been selling assets since the end of 2013, which helps to further improve its solvency position. Therefore, the stress test exercise does not affect the current restructuring plan of Dexia approved by the European Commission in 2012 and no additional action is required from the group.

The stress test results show that the institutions have a comfortable capital level in the baseline scenario, and have a good resistance to severe shocks, such as those provided for in the adverse scenario. However, the exercise highlights the importance for the banking sector to further diversify its income and funding structure. In addition, the banks are invited to learn from the exercise by further reflecting on the orientation of their business model. In order to ensure a sustainable profitability level and to sustain the Belgian economy, they must continue their restructuring and rationalization efforts.

**Evolution of CET1 in baseline scenario and adverse scenario**

| | *2013* | *2016 baseline* | *2016 adverse* |
|---|---|---|---|
| **SSM** | **11.8%** | **11.6%** | **8.4%** |
| **Belgium** | **14.6%** | **12.1%** | **7.4%** |
| **Belgium (excluding Dexia)** | **14.0%** | **12.5%** | **8.2%** |

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