FINANCIAL PERFORMANCE OF EUROPEAN BANKS IN THE CONTEXT OF THE COVID-19 CRISIS

KEY FINDINGS BASED ON INTERIM FINANCIAL STATEMENTS AS AT 30 JUNE 2020

A FOCUS ON EXPECTED CREDIT LOSSES (ECL)

September 2020

MAZARS

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KEY POINTS

x 3.1
Median increase in ECL Charge in P&L (H1 2020 vs H1 2019)

22%
Average increase in ECL allowance, i.e. stock of provisions for ECL on balance sheet (vs an average increase of 7% in gross credit exposure)

72%
Average share of ECL charge within Operating income before ECL in H1 2020 (vs 22% at YE 2019)

The increase in the ECL allowance is mainly explained by:

i) a higher coverage ratio for stage 1 (+20%), and

ii) an increased proportion of stage 2 gross exposure

1.
EXECUTIVE SUMMARY

Increasing ECL charge and diminishing Operating income before ECL compared to H1 2019 have resulted in a lower profitability in H1 2020:

- All banks experienced a significant increase of their ECL Charge in H1 2020 compared to H1 2019 (median is x3.1);

- At the same time, most banks experienced a decrease in their H1 Operating income before ECL compared to H1 2019;

- As a consequence, the share of ECL charge within Operating income is much higher than the same period last year (the median ratio increased from 22% to 72%).

A general increase in global ECL coverage ratio has been observed in H2 2020:

- All banks in our sample experienced an increase in both their gross credit exposure and in their ECL allowance compared to YE 2019;

- However, for all banks but one, the ECL allowance increased much more (average @ +22%) than the gross credit exposure (average @ +7%);

- As a result, the average global ECL coverage ratio increased by 10% (from 1% at YE 2019 to 1.1% in H1 2020 on average).

The ECL allowance has increased for all banks during H1 2020 but the extent of the increase varies from one bank to another:

- H1 2020 ECL charge represented on average 33% of the ECL allowance opening balance at the beginning of 2020,

- But the individual results are quite diverse, ranging from 10% to 73%.

- Banks with the highest "incremental" ECL charges (as a % of opening loss allowance) had low Global ECL coverage ratios at YE 2019.

**The increase in the ECL allowance may be explained mainly by:**

- A higher Stage 1 coverage ratio (with an average increase of 20%);

- And an increased average proportion of Stage 2 gross carrying amounts (lower proportion of stage 1, proportion of stage 3 being stable).

Post-model adjustments have modified the ECL amounts, with significant differences from one bank to another:

- Eight banks have disclosed the amount of post-model adjustments, ranging from -66% to +23% of their reported ECL charge for H1 2020.

- Negative percentages (for two banks in our sample) mean that the adjustments actually reduced the amount of ECL that would have been reported otherwise.

Banks applied different strategies to the change in weightings allocated to negative and positive macro-economic scenarios:

- Two banks decided to increase the weight of the negative scenario(s). One bank has done so to reflect a higher level of uncertainty due to COVID-19;

- Two banks decided not to change the weightings compared to YE 2019;

- Two banks decided to reduce the weight of the negative scenario(s). One bank has done so due to the current situation being below the average of the credit cycle.
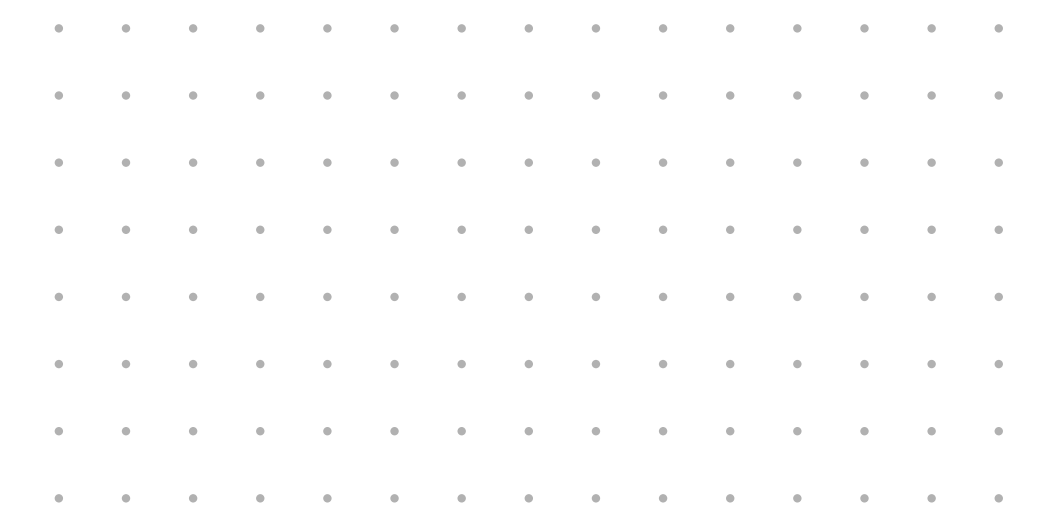
2.
SAMPLE AND METHODOLOGY

Our sample is composed of **13 European banking groups** publishing their financial statements under the IFRS framework:
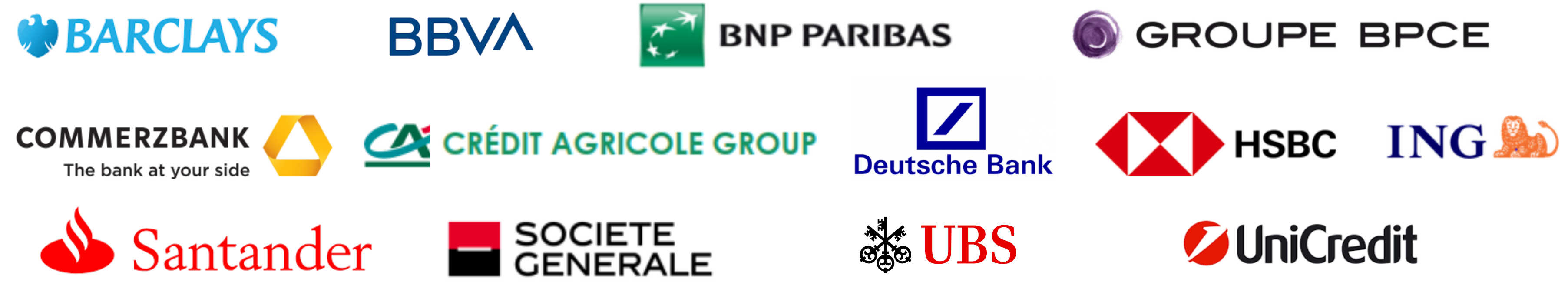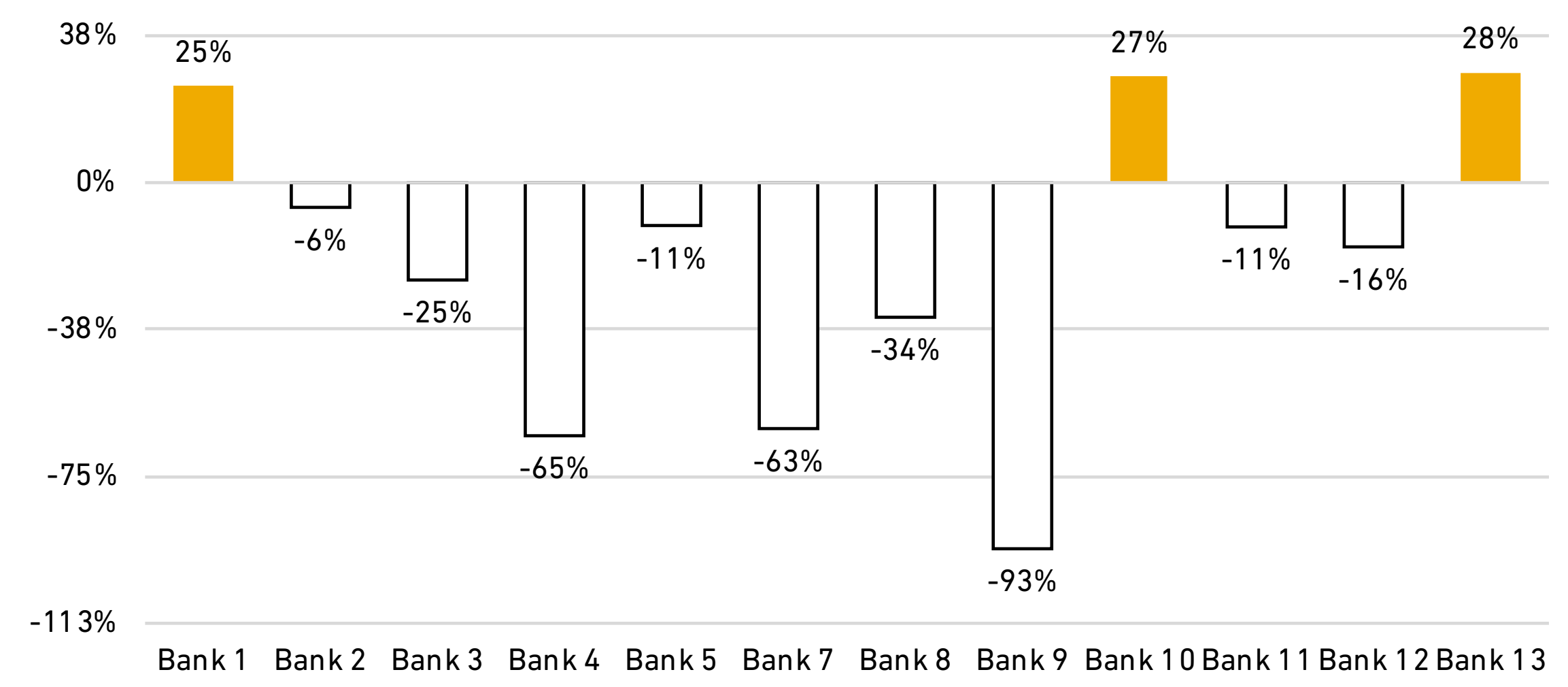

DISCLAIMER & METHODOLOGY

- Our analysis is based on publicly available information from the interim reports of the banks in our sample at 30 June 2020, some of which are unaudited.

- Media releases and investor-oriented presentations, or similar publications, have not been taken into account.

- Some figures presented (such as the ECL coverage ratio by stage or ECL charge for H1 expressed as a percentage of total ECL allowance) are not necessarily directly available in the interim reports : they are issued from our calculations using input data available in the interim reports. **Graphs using figures that required specific calculations are indicated with the "magnifying glass" sign.** The detailed methodology for producing such figures is explained below the graphs. Comparisons of such figures may sometimes be perilous simply because banks may not provide the necessary data for exactly the same scope of instruments, or because we needed to make some assumptions to render the data equivalent.

- If less than 13 banks appear in our graphs with anonymised banks, it means we did not manage to find all the data needed in the H1 2020 interim report for the bank in question.

- Comparison of quantitative findings should be done with care, as banks' portfolios are different in nature and risk profile. Often more granular additional information (than that provided in the interim reports), e.g. by geographical area or by type of loan, would be necessary to fully understand the differences in the results of different banks.

3.
KEY FINDINGS

3.1 CHANGE IN OPERATING PROFIT OR LOSS BEFORE ECL: H1 2020 VS H1 2019

Change in operating P&L before ECL charge, in % (H1 2020 vs H1 2019)

Bar values: Bank 1: 25%, Bank 2: -6%, Bank 3: -25%, Bank 4: -65%, Bank 5: -11%, Bank 7: -63%, Bank 8: -34%, Bank 9: -93%, Bank 10: 27%, Bank 11: -11%, Bank 12: -16%, Bank 13: 28%
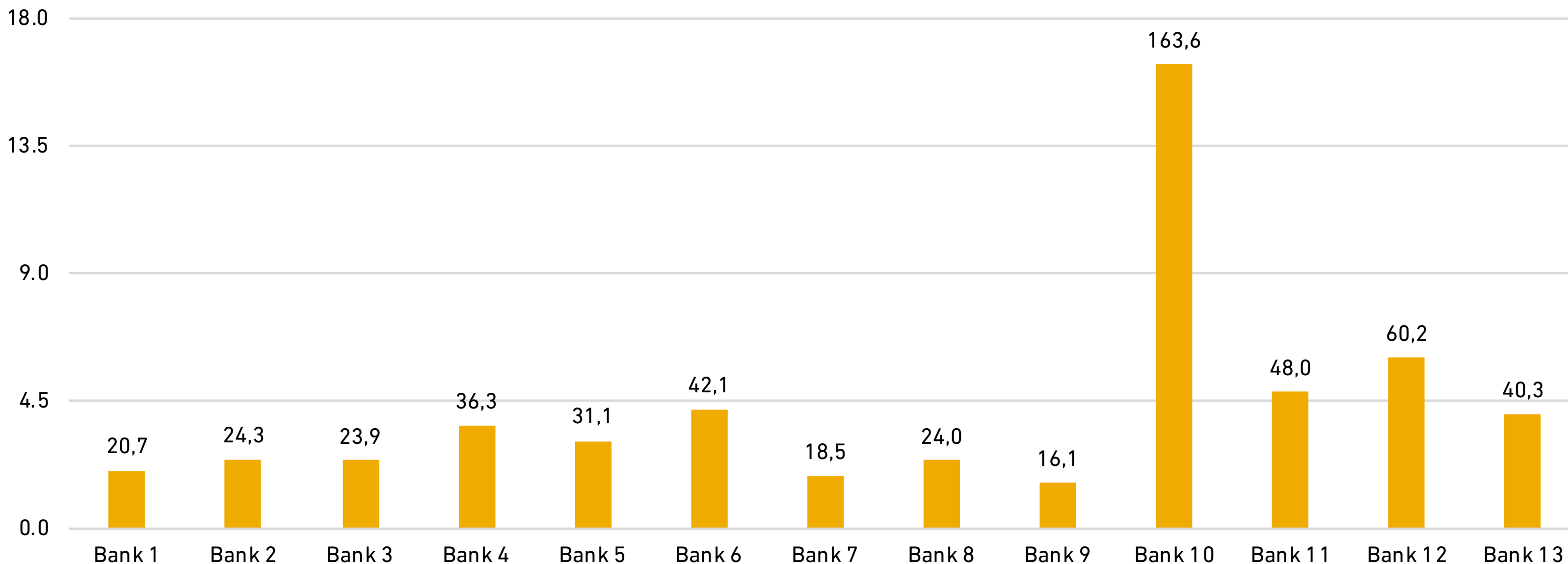
MAZARS INSIGHTS:

- Most of the banks (9 out of 13) experienced **decreases** in their operating profit before ECL.

- Only four banks in our sample saw a **positive** growth in their operating profit before ECL charge.

- Bank 6 is not represented on this graph as the growth of more than 500% is simply due to the fact that the 2019 H1 value was negative.

The indicator shown in this Graph is an indirect measure: we calculated it from the data in the income statements of the banks in our sample. This "operating profit before ECL charge" indicator includes salaries and other operating expenses, amortisation, depreciation or impairment charge for tangible and intangible non-financial assets (if any), but it does not include "non-operating" income or expense such as share in the income of associates and joint ventures or profit from disposal of non-financial assets. As the title indicates, it also excludes the ECL charge for the period. Given the diversity in the presentation of different lines in the income statement by European banks, this indicator should be seen as a **broad measure of revenue net of most operating expenses,** rather than a universal measure of net profitability before impairment (we cannot guarantee that exactly the same items are captured within this amount for all banks in the samples. Sometimes the income statement is not precise enough, so some allocations we operated could be seen as arbitrary).

3.2 INCREASE IN ECL CHARGE: H1 2020 VS H1 2019

ECL charge multiplier effect: H1 2020 vs H1 2019

MAZARS INSIGHTS:

- The ECL charge increased by x4.2 on average, and the median multiplier effect was x3.1.

- The increase in the ECL charge has to be analysed together with other relevant metrics, such as allocation of exposures by stages, ECL coverage ratio or the pre-crisis stock of impairment allowance (see next slides).

- To illustrate : Bank 10 experienced a more than 16-fold increase in the ECL charge compared to the same period last year. But one should keep in mind that, at the end of 2019, Bank 10 had the highest share of Stage 1 exposures (97%) and the lowest coverage ratio for each stage. So its "starting point" was different from that of the other banks.
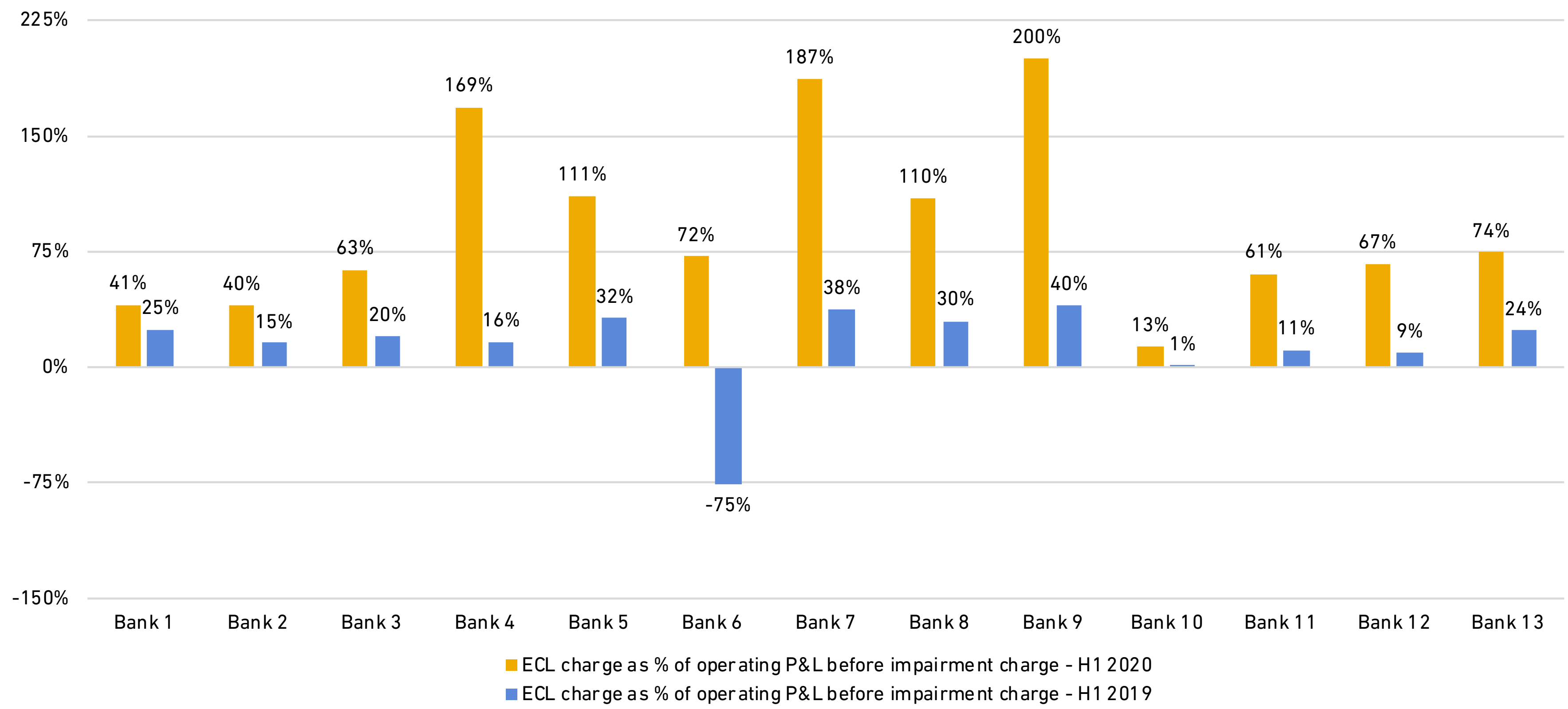
The data above should be interpreted with care, to avoid hasty conclusions.

We used the profit or loss statement information to extract this data, as often banks isolate the ECL / fin. Instruments impairment charge within a single line of P&L (such as a line called "cost of risk" in France). However, one bank in our sample has included part of the ECL charge relating to off-balance sheet commitments within another line of P&L, and even though we could include this part of charge for H1 2020 in our graph based on the information provided in the notes to financial statements, we were unable to identify the corresponding charge amount of such commitments for the comparative period.

Another limitation of using the statement information directly is that often the ECL charge within the "cost of risk" (or similar) line is "aggregated" with factors that do not stem directly from the IFRS 9 ECL models, such as expenses relating to fraud or to disputes related to the financing activity. Lack of homogeneity as to the inclusion or not of such costs within the cost of risk line hinders comparison between banks.

3.3 SHARE OF ECL CHARGE IN OPERATING PROFIT OR LOSS BEFORE ECL : H1 2020 VS H1 2019

ECL charge as a percentage of operating P&L before ECL

Legend:
- ECL charge as % of operating P&L before impairment charge – H1 2020
- ECL charge as % of operating P&L before impairment charge – H1 2019

MAZARS INSIGHTS:

- **The ECL charge represents a much more significant portion of the Operating profit or loss before ECL in H1 2020 compared to YE 2019.**

- The median ratio of ECL charge divided by the operating profit before ECL amounted to **72%** in H1 2020 (against **22%** in H1 2019).

- Bank 6 appears with a negative value for H1 2019 as its operating income before ECL was negative in H1 2019.

- Bank 9 exhibits a ratio of 987% in H1 2020 because its ECL charge was nearly 10 times bigger than its operating profit before ECL.

See section 3.1 for an explanation of how we calculated **operating profit or loss before the ECL charge** for the denominator of the ratio.

3.4 INCREASE IN ECL ALLOWANCE AND IN GROSS CREDIT EXPOSURE : H1 2020 VS YE 2019

Increase in gross credit exposure and in ECL allowance in H1 2020 compared to YE 2019

■ Change in gross carrying amount
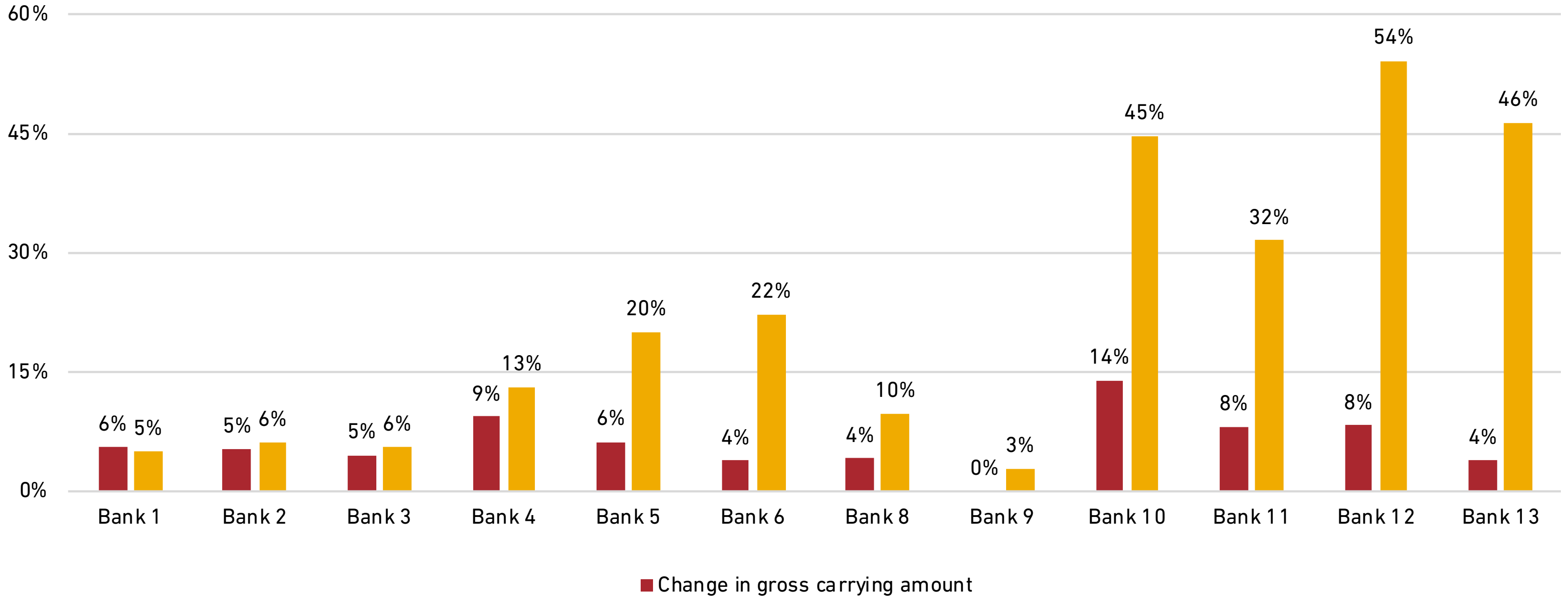
MAZARS INSIGHTS:

- In H1 2020, all the banks in our sample experienced an increase in **both** their gross credit exposure and in their ECL allowance compared to YE 2019.

- However, ECL allowance increased much more on average (**+22%**) than the gross credit exposure (**+7%**).

Note that the definition of the (gross) exposure is not always provided and for some banks it may differ from the definition of a "gross carrying amount" under IFRS 9, which is supposed to reflect more or less the notional amount before impairment (e.g. fair value rather than gross carrying amount may be included for assets measured at FV-OCI with recycling to P&L). The amounts of off-balance sheet commitments have been excluded from the data on exposures by some banks. The figures in Graph 6 allow, however, to have some indication as to the change in volumes of instruments subject to the IFRS 9 impairment model.

Note that some banks did not disclose the total amounts of their ECL allowance: for several banks, the amount of ECL provisions for loan commitments and guarantees issued was not provided. When possible, we then also excluded such items from the gross exposure values.

3.5 INCREASE IN GLOBAL ECL COVERAGE RATIO : H1 2020 VS YE 2019

Global ECL coverage ratio

MAZARS INSIGHTS:

- All banks experienced an increase in their global coverage ratio, except for Bank 1 (the global coverage of which decreased from 1.55% to 1.54%).

- The global coverage ratio **increased by 10% on average** (from 1% to 1.1%) for the 11 banks with comparative information for YE 2019 available in their H1 2020 interim report.

- See next slides for a focus on the coverage ratio by stage

Bank 13: 0,97% / 1,36%
Bank 12: 0,35% / 0,50%
Bank 11: 0,53% / 0,65%
Bank 10: 0,15% / 0,20%
Bank 9: 0,00% / 2,43%
Bank 8: 2,45% / 2,59%
Bank 7: 0,00% / 2,59%
Bank 6: 0,45% / 0,53%
Bank 5: 0,62% / 0,71%
Bank 4: 1,38% / 1,43%
Bank 3: 1,33% / 1,34%
Bank 2: 1,24% / 1,25%
Bank 1: 1,55% / 1,54%

0,00% — 0,75% — 1,50% — 2,25% — 3,00%

■ Global coverage at 2019.12.31   ■ Global coverage at 2020.06.30
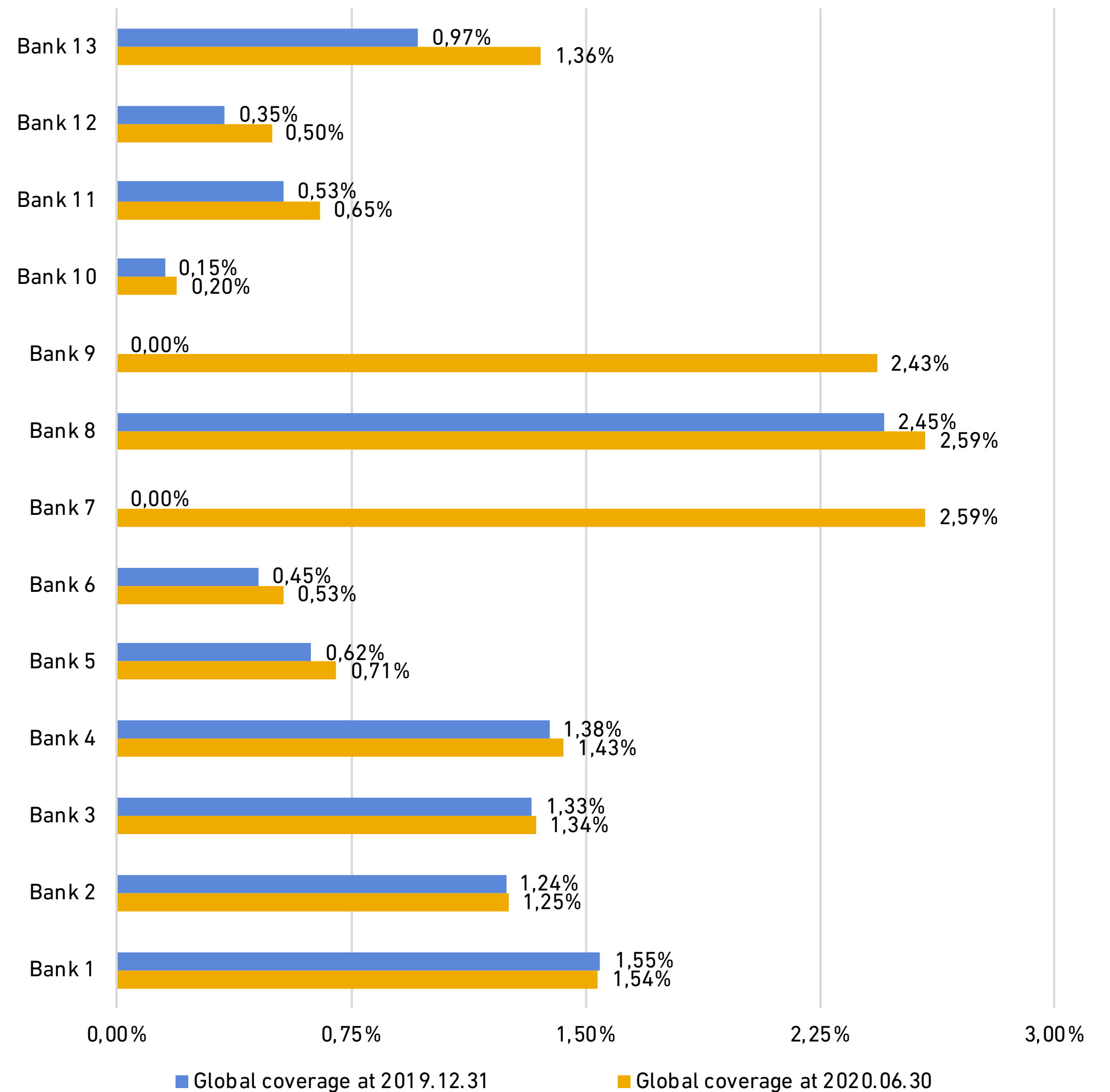
We calculated the coverage ratio for each bank by dividing the ECL allowance on the balance-sheet by the gross credit exposure (using data in **Graph 6**).

The limitations of data used to calculate these metrics are explained on previous slide.

3.6 INCREMENTAL ECL DURING H1 2020

Incremental ECL (charge for H1 2020 expressed as a % of ECL allowance at YE 2019)
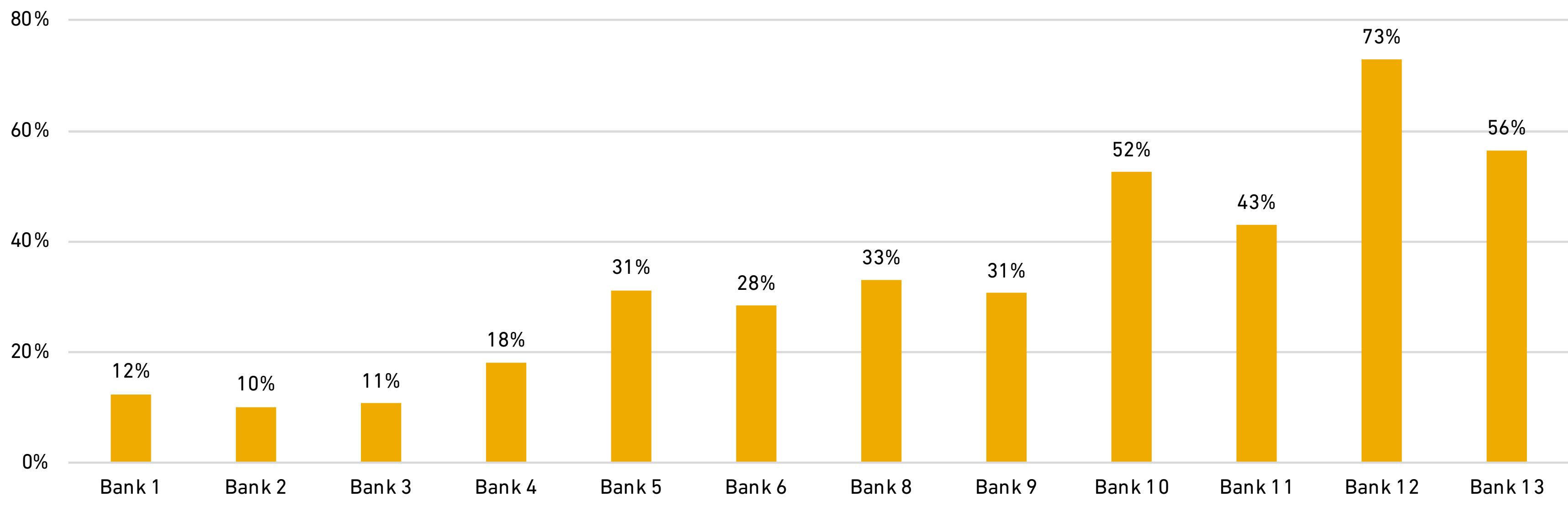
MAZARS INSIGHTS:

- **H1 2020 ECL charge represented on average 33% of the accumulated ECL allowance at YE 2019,**

  - But the individual results are quite diverse, ranging from 10% to 73%.

- **Among the four banks with the highest ratio:**

  - Three banks had a low global ECL coverage ratio at YE 2019 (see Bank 10, Bank 11 and Bank 12 on previous page), and

  - Bank 13 experienced a significant increase in its ECL coverage ratio compared to last year.

Note that some banks did not disclose the total amounts of their ECL allowance: for several banks the amount of ECL provisions for loan commitments and guarantees issued was not provided.

3.7 BREAKDOWN OF GROSS CREDIT EXPOSURE BY STAGE: H1 2020 VS YE 2019

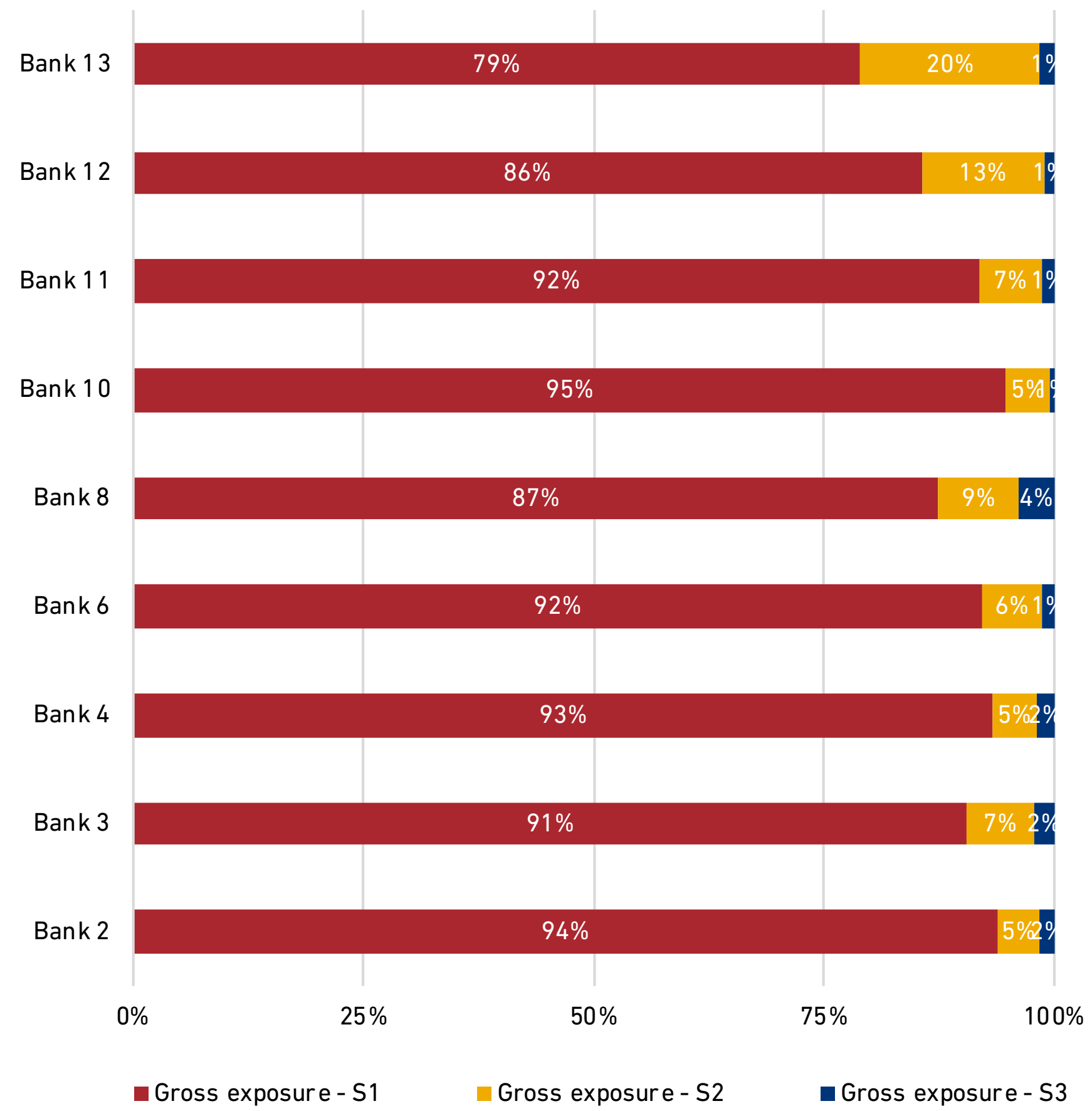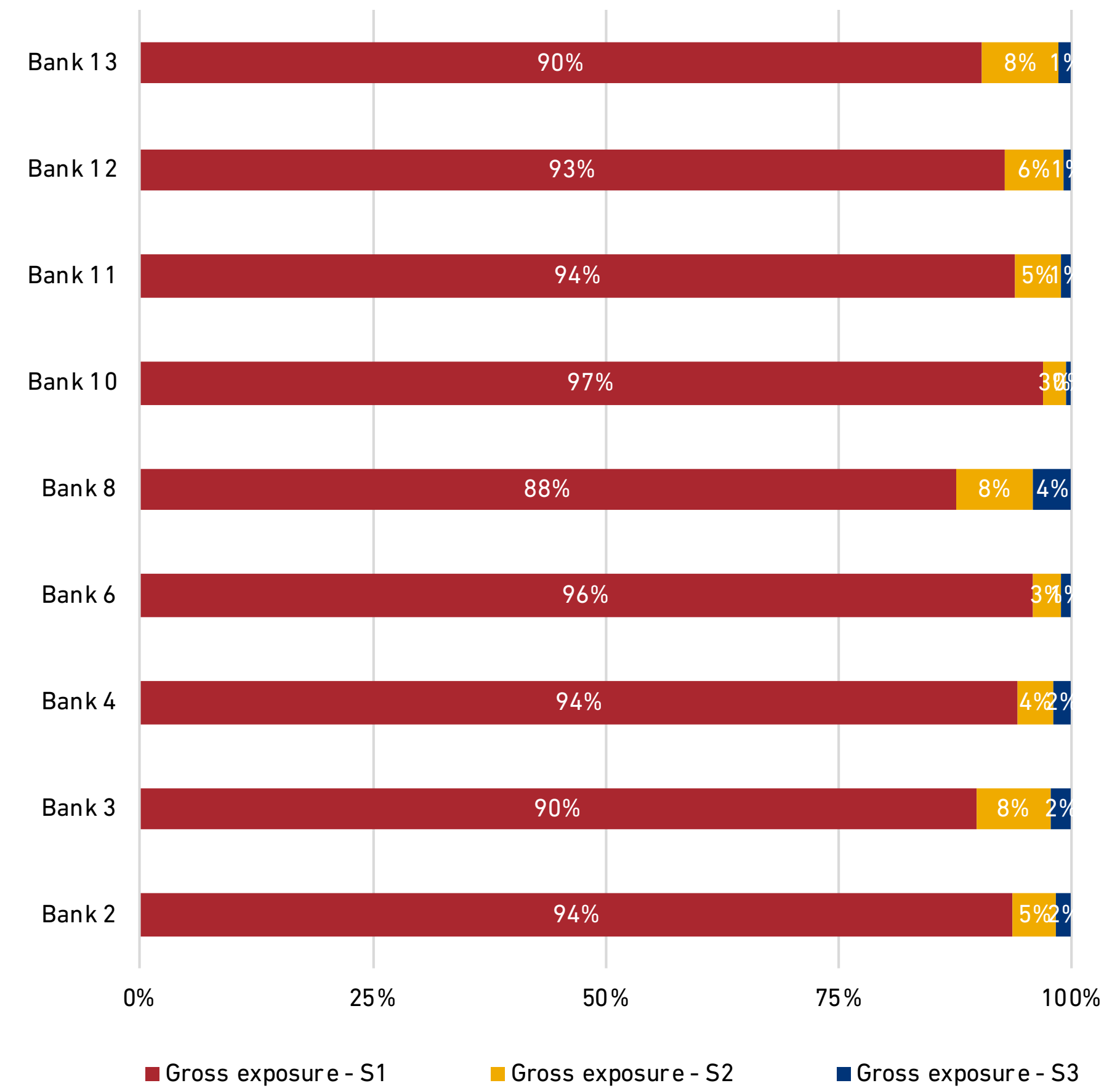### MAZARS INSIGHTS:

- **The general trend, on average, has been a transfer of 3% of gross credit exposure from Stage 1 to Stage 2 in H1 2020.**

- The average proportion of Stage 2 has increased from 5.5% to 8.5% while the average share of Stage 1 has decreased from 93% to 90%

- The share of Stage 3 has remained stable.

Note that for some banks the Stage 3 amounts include POCI. Some banks provided a breakdown by stage for most asset classes, but not necessarily all asset classes. The allocations by stages therefore are not directly comparable across banks. Comparability of the weight of Stage 3 may be further hindered by potentially different write-off policies.

Allocation of gross credit exposure at 30 June 2020 by stage

Bank	S1	S2	S3
Bank 13	79%	20%	1%
Bank 12	86%	13%	1%
Bank 11	92%	7%	1%
Bank 10	95%	5%	
Bank 8	87%	9%	4%
Bank 6	92%	6%	1%
Bank 4	93%	5%	2%
Bank 3	91%	7%	2%
Bank 2	94%	5%	2%

■ Gross exposure - S1 ■ Gross exposure - S2 ■ Gross exposure - S3

Allocation of gross credit exposure at 31 December 2019 by stage

Bank	S1	S2	S3
Bank 13	90%	8%	1%
Bank 12	93%	6%	1%
Bank 11	94%	5%	1%
Bank 10	97%	3%	
Bank 8	88%	8%	4%
Bank 6	96%	3%	
Bank 4	94%	4%	2%
Bank 3	90%	8%	2%
Bank 2	94%	5%	2%

■ Gross exposure - S1 ■ Gross exposure - S2 ■ Gross exposure - S3

3.8 BREAKDOWN OF ECL ALLOWANCE BY STAGE: H1 2020 VS YE 2019

MAZARS INSIGHTS:

- The share of **Stage 2** ECL allowance has increased from 19% to 23% on an average.

- The share of **Stage 1** ECL allowance remains stable despite the decrease in Stage 1 credit exposure due to higher coverage ratio.

- The share of **Stage 3** ECL has decreased by 4% due to stable coverage ratio (whereas coverage ratio of Stage 1 and Stage 2 has increased significantly, see next slide).
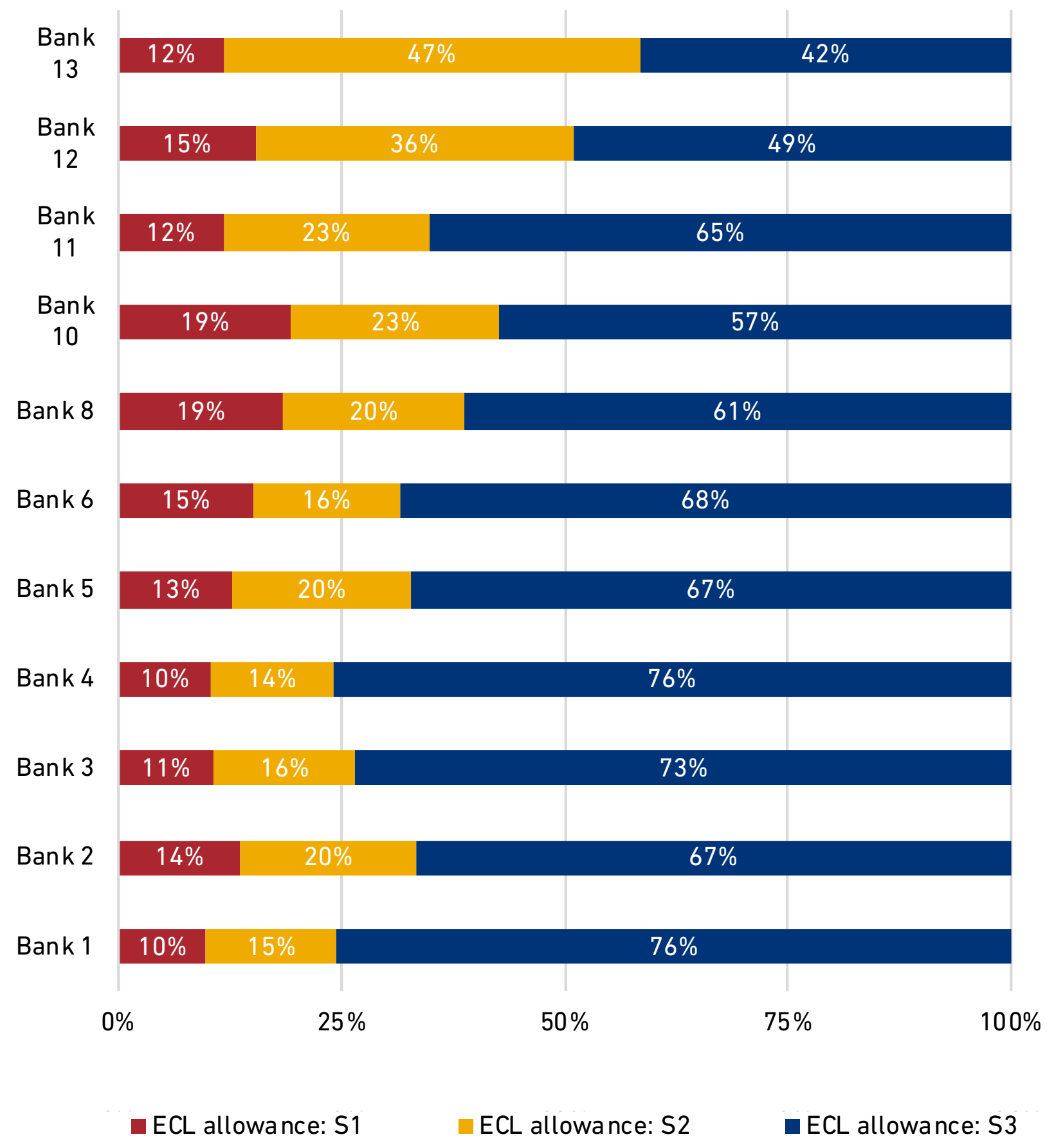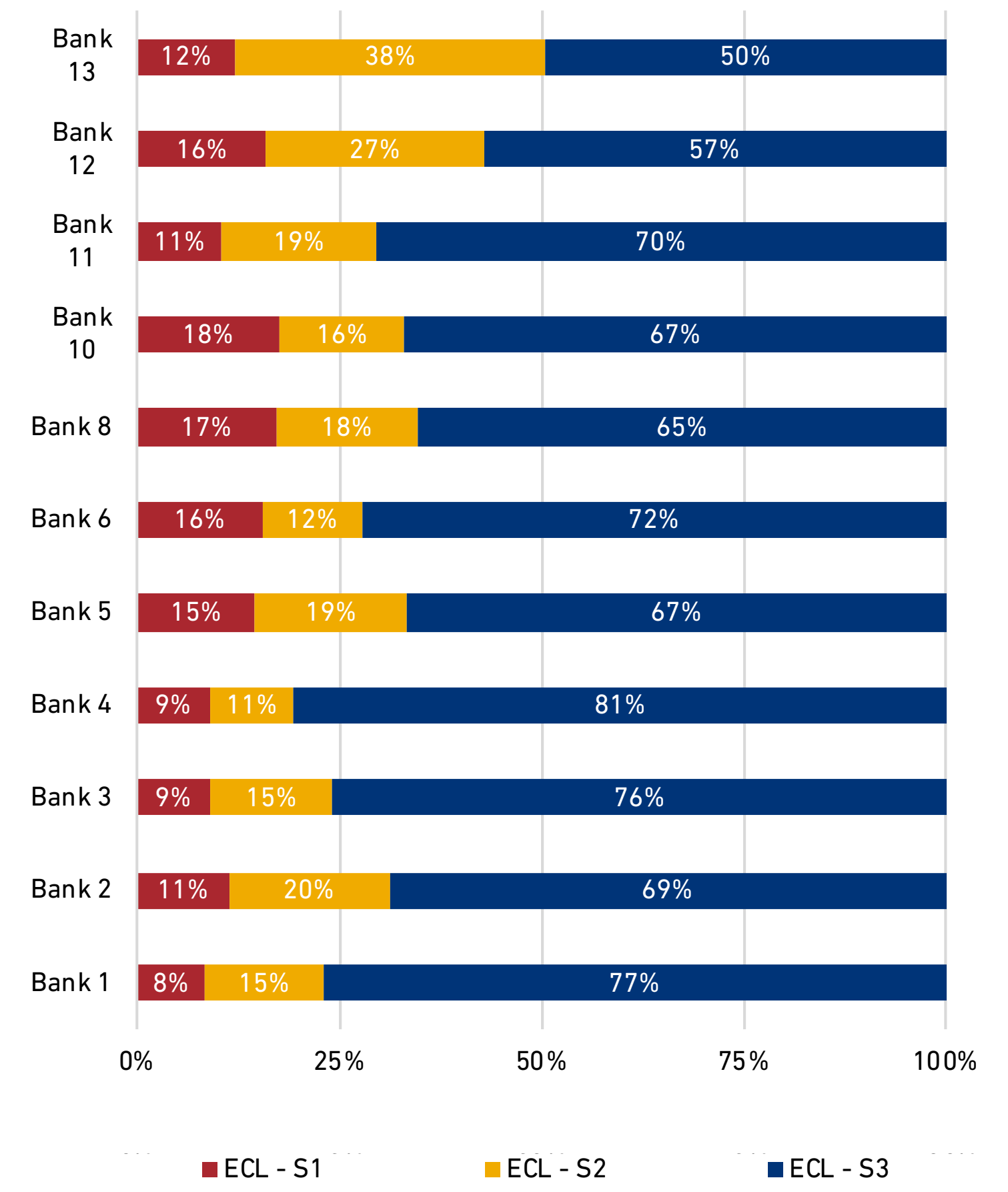
Note that for some banks the Stage 3 amounts include POCI. Some banks provided a breakdown by stage for most asset classes, but not necessarily all asset classes. The allocations by stages therefore are not directly comparable across banks. Comparability of the weight of Stage 3 may be further hindered by potentially different write-off policies.

Allocation of the ECL allowance at 30 June 2020 by stage

Bank	S1	S2	S3
Bank 13	12%	47%	42%
Bank 12	15%	36%	49%
Bank 11	12%	23%	65%
Bank 10	19%	23%	57%
Bank 8	19%	20%	61%
Bank 6	15%	16%	68%
Bank 5	13%	20%	67%
Bank 4	10%	14%	76%
Bank 3	11%	16%	73%
Bank 2	14%	20%	67%
Bank 1	10%	15%	76%

■ ECL allowance: S1 ■ ECL allowance: S2 ■ ECL allowance: S3

Allocation of the ECL allowance at 31 December 2019 by stage

Bank	S1	S2	S3
Bank 13	12%	38%	50%
Bank 12	16%	27%	57%
Bank 11	11%	19%	70%
Bank 10	18%	16%	67%
Bank 8	17%	18%	65%
Bank 6	16%	12%	72%
Bank 5	15%	19%	67%
Bank 4	9%	11%	81%
Bank 3	9%	15%	76%
Bank 2	11%	20%	69%
Bank 1	8%	15%	77%

■ ECL - S1 ■ ECL - S2 ■ ECL - S3

3.9 ECL COVERAGE RATIO BY STAGE : H1 2020 VS YE 2019

Stage 1 coverage ratio (H1 2020 and YE 2019)

Bank	S1 YE 2019	S1 H1 2020
Bank 13	0,13%	0,20%
Bank 12	0,09%	0,15%
Bank 11	0,06%	0,08%
Bank 10	0,03%	0,04%
Bank 8	0,62%	0,72%
Bank 6	0,07%	0,09%
Bank 4	0,13%	0,16%
Bank 3	0,13%	0,16%
Bank 2	0,15%	0,18%

■ S1 Coverage ratio – YE 2019   ■ S1 Coverage ratio – H1 2020

Stage 2 coverage ratio (H1 2020 and YE 2019)

Bank	S2 YE 2019	S2 H1 2020
Bank 13	4,43%	3,23%
Bank 12	2,31%	2,22%
Bank 11	2,14%	2,25%
Bank 10	0,88%	0,97%
Bank 8	6,54%	7,91%
Bank 6	1,77%	1,36%
Bank 4	4,07%	4,25%
Bank 3	2,53%	3,01%
Bank 2	5,36%	5,39%

■ S2 Coverage ratio – YE 2019   ■ S2 Coverage ratio – H1 2020

Stage 3 coverage ratio (H1 2020 and YE 2019)

Bank	S3 YE 2019	S3 H1 2020
Bank 13	37%	38%
Bank 12	36%	37%
Bank 11	30%	30%
Bank 10	22%	22%
Bank 8	51%	53%
Bank 6	29%	27%
Bank 4	54%	53%
Bank 3	45%	42%
Bank 2	53%	53%

■ S3 Coverage ratio – YE 2019   ■ S3 Coverage ratio – H1 2020
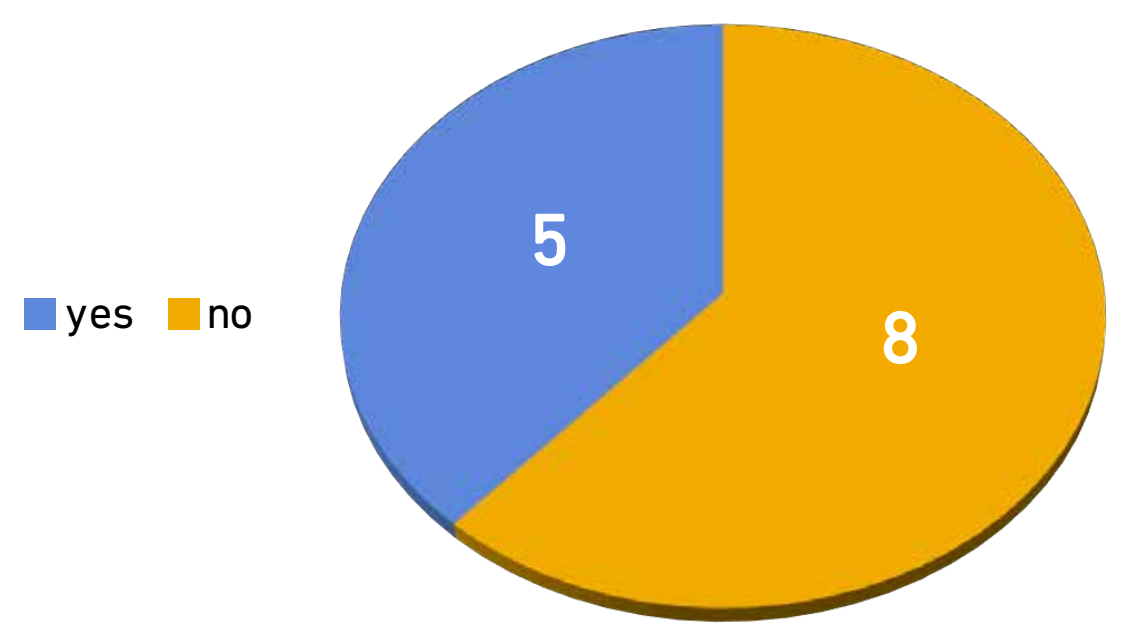
MAZARS INSIGHTS:

- **All nine banks** disclosing data necessary to calculate the ECL coverage ratio by stage at both reporting dates have **increased their Stage 1 Coverage ratios, with an average increase of 20%** (from 0.16% at YE 2019 to 0.20% in H1 2020 on average).

- 2/3 of the banks have increased their Stage 2 ECL coverage ratio, with an average increase of +1.8%.

- The Stage 3 coverage ratio has remained more or less stable (-0.5% on average).
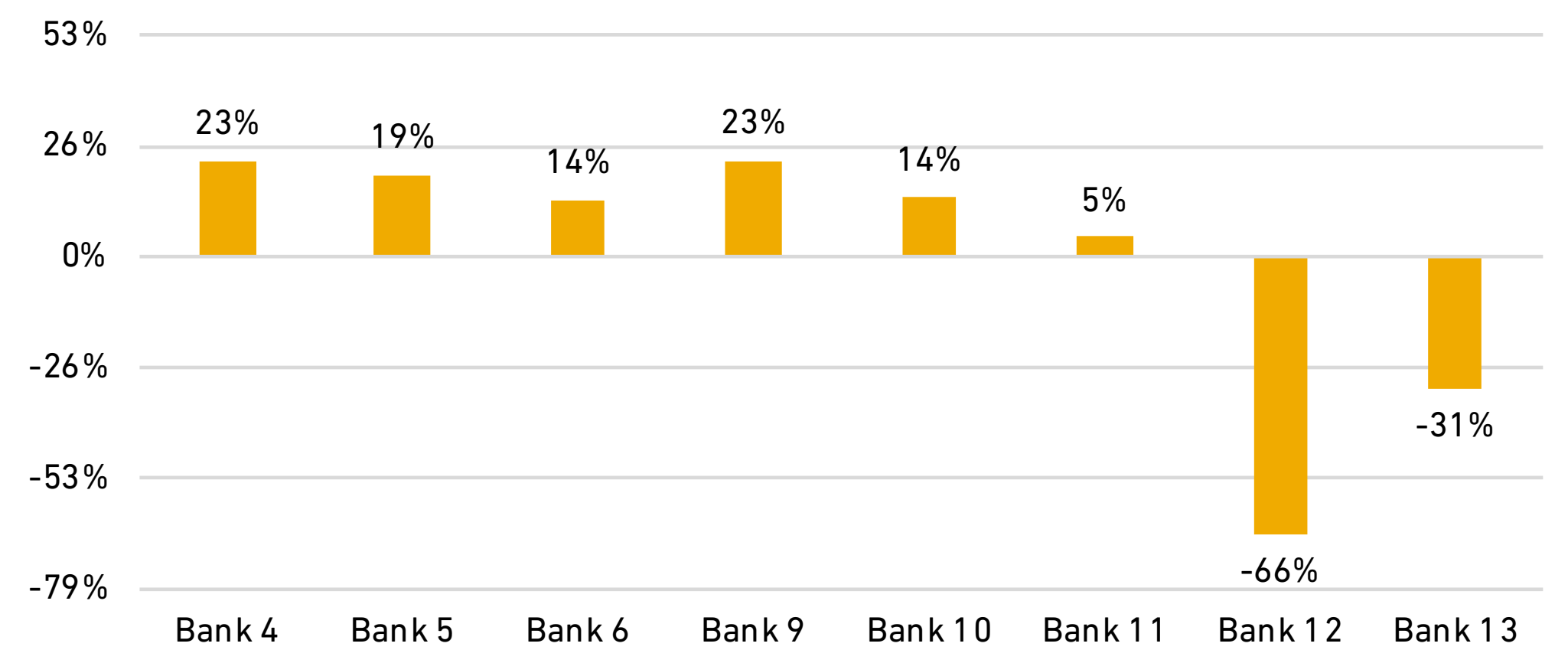
The limitations in relation to the data used to calculate these metrics are explained under Graphs 11 to 14. Our methodology for calculating the global coverage ratio is presented under **Graph 7**: the same methodology is applied for computing the ratio by stage.

3.10 IMPACT OF POST-MODEL ADJUSTMENTS AND MANAGEMENT OVERLAYS

Banks having disclosed the amount of management overlays or post-model ECL adjustments

yes no

5

8

Extent of management overlays and post-model adjustments (as a % of 2020 H1 ECL charge)

| | Bank 4 | Bank 5 | Bank 6 | Bank 9 | Bank 10 | Bank 11 | Bank 12 | Bank 13 |
| 23% | 19% | 14% | 23% | 14% | 5% | -66% | -31% |

Please note that part of these management overlays and post-model adjustments may be unrelated to the COVID-19 crisis.
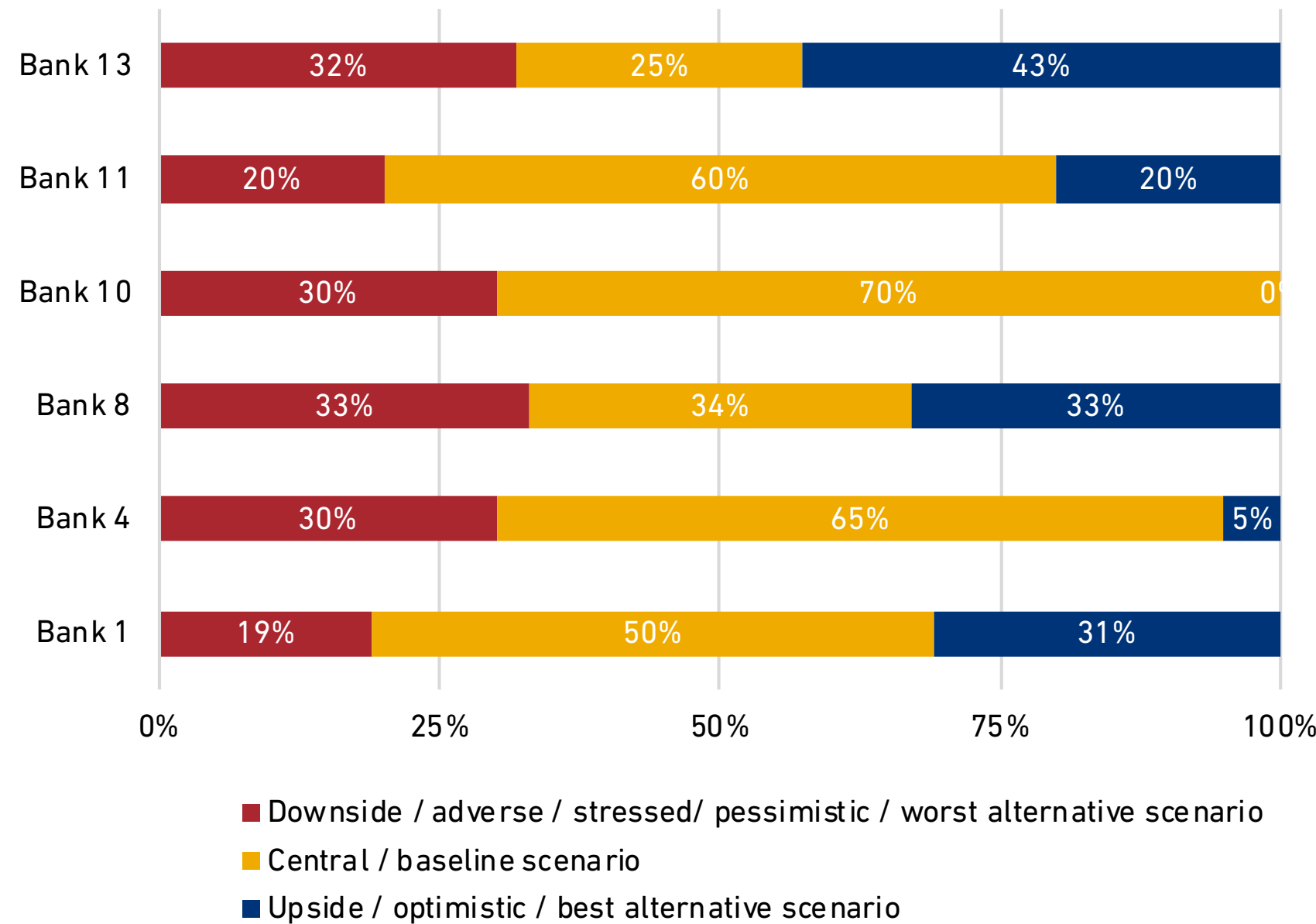
MAZARS INSIGHTS:

- Eight banks have disclosed the **impact amount of post-model adjustments, ranging from -66% to +23% of their reported ECL** charge for H1 2020.

- Negative percentages (for two banks in our sample) mean that the adjustments actually reduced the amount of ECL that would have been reported otherwise.

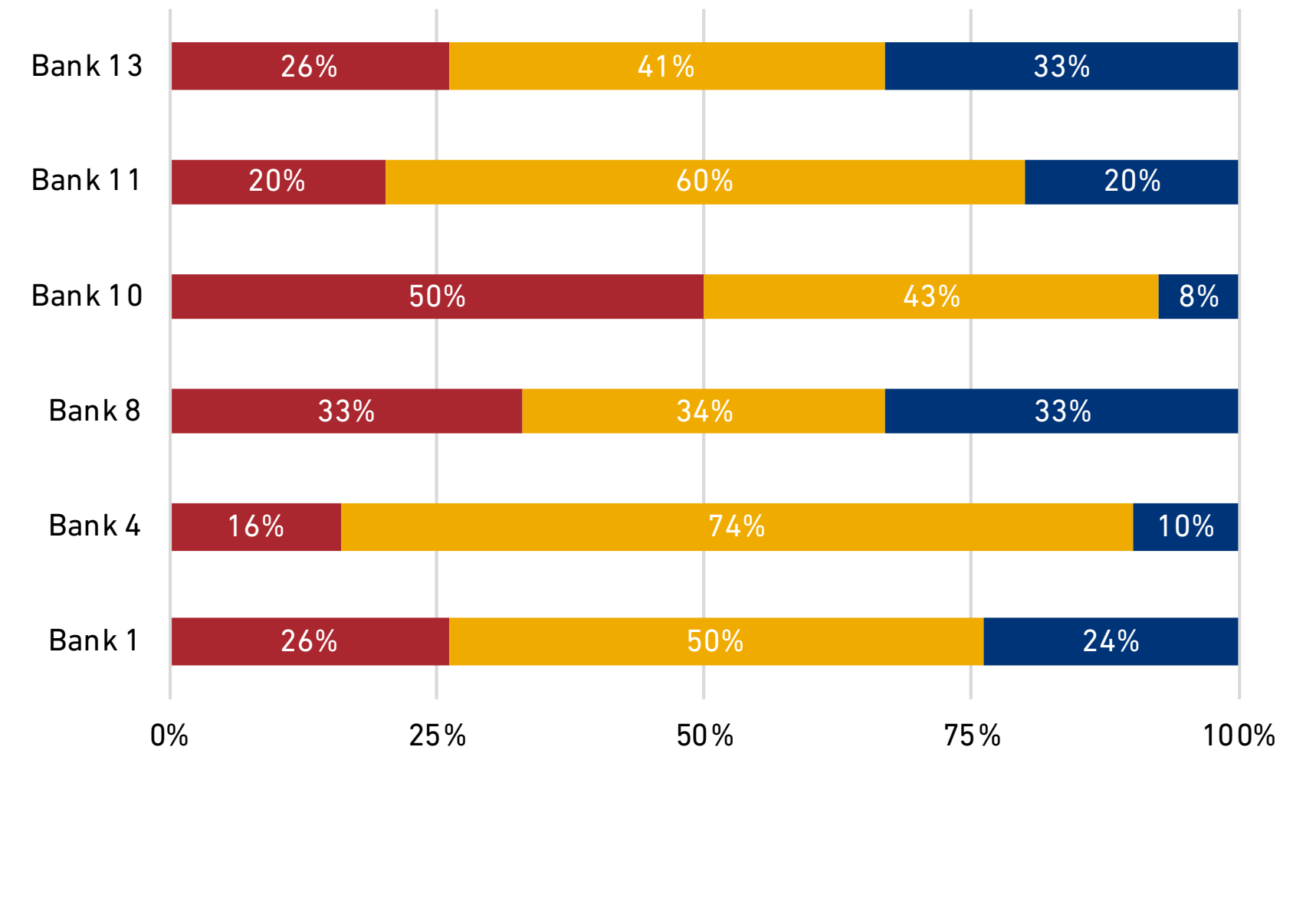# 3.11 MACRO-ECONOMIC SCENARIO WEIGHTINGS : H1 2020 VS YE 2019

MAZARS INSIGHTS:

- Two banks have **increased the weighting of their negative scenario(s).**

  - Bank 13 explains having assigned greater weight to the tail upside and downside scenarios to reflect a wider range of uncertainty in the economic environment because of COVID-19.

- Two banks have **decreased the weighting of their negative scenario(s).**

  - Bank 1 explained that it computes the weighting of the two alternative scenarios based on the position in the credit cycle: the adverse scenario receives a higher weight when the economy is in strong expansion. As the situation was below the average of the credit cycle at 30 June 2020, the adverse scenario received a lower weight.

- Two banks have maintained the weightings **unchanged** in H1 2020 compared to YE 2019.

Weightings assigned to the different scenarios at H1 2020

Bank	Downside	Central	Upside
Bank 13	32%	25%	43%
Bank 11	20%	60%	20%
Bank 10	30%	70%	0%
Bank 8	33%	34%	33%
Bank 4	30%	65%	5%
Bank 1	19%	50%	31%

Weightings assigned to the different scenarios at YE 2019

Bank	Downside	Central	Upside
Bank 13	26%	41%	33%
Bank 11	20%	60%	20%
Bank 10	50%	43%	8%
Bank 8	33%	34%	33%
Bank 4	16%	74%	10%
Bank 1	26%	50%	24%

■ Downside / adverse / stressed/ pessimistic / worst alternative scenario
■ Central / baseline scenario
■ Upside / optimistic / best alternative scenario

Please note that these weightings cannot be analysed fully on their own without paying attention to the macro economic forecasts underlying each scenario.

Note that banks 4, 10 and 13 actually use more than three scenarios (three of these banks have two downside scenarios and one of them has two upside scenarios). We summed up the weights of the negative scenarios for each bank (and also the weight of the positive scenarios for one bank) so as to have a single weighting for each of the three broad categories.

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ABOUT MAZARS

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