Covid-19: disclosed financial performance of European banks

A focus on Expected Credit Losses

Based on 2020 annual reports provided by European banks before 1 April 2021

mazars

Table of contents

04 Executive summary
06 Sample and methodology
09 Key findings

1.1 Executive summary

The increase in the Expected Credit Losses (ECL) allowance is mainly explained by:

- **Higher coverage ratios for stage 1 and stage 2**
- **An increased proportion of stage 2 gross exposure**
- **Significant post-model adjustments**

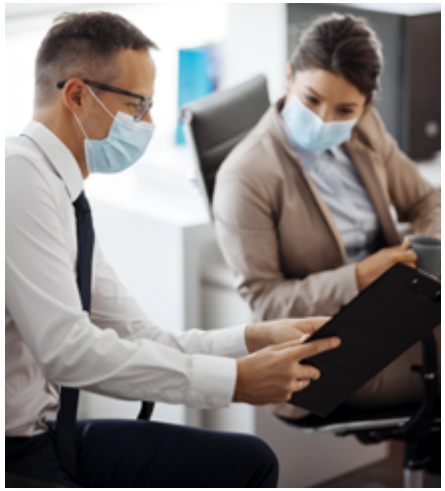
The quality of disclosures has improved overall, even if the persistent lack of granularity for some banks reduces the comparability between banks.

x 3.5

average 2020 ECL charge increase vs. 2019 (x6 H1 2020 vs. H1 2019)

28%

average 2020 ECL allowance increase vs. 2019 (and +7% in gross credit exposure)



78%

average share of ECL charge within the operating profit or loss before ECL at YE 2020 (vs. 21% at YE 2019)

27%

average weight of the post-model adjustments in the ECL charge at YE 2020

1.2 Executive summary

Increasing the ECL charge and lowering the operating profit or loss before the ECL in comparison to YE 2019 has resulted in a lower profitability at YE 2020

- As in H1 2020, most banks experienced a significant increase of their ECL charge at YE 2020 in comparison to YE 2019 (average multiplier effect x3.5). At the same time, they saw a decrease in their operating profit or loss before ECL at YE 2020 vs. YE 2019.
- Consequently, the share of the ECL charge within the operating income was much higher at YE 2020 than at YE 2019: the average ratio increased from 21% to 78%.

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

- ECL charge at YE 2020 represented, on average, 57% of the ECL allowance at YE 2019.
- The ECL increase has not been linear over 2020, as the ECL charge at YE 2020 represented on average 57% of the ECL allowance at YE 2019 vs. 41% at H1 2020.
- The banks with the higher incremental ECL charge do not always have the highest coverage ratio: within the seven banks that issued an incremental ECL charge above 80%, five of them had a global coverage ratio below the average of 1.15% at YE 2020.

An overall increase in the ECL coverage ratio has been observed at YE 2020

- The average global ECL coverage ratio increased by almost 12% from 1.03% to 1.15%.
- This was caused by an average increase in ECL allowance of 28% alongside 7% for gross credit exposures.
- For amortised cost assets, the coverage ratio increased from 1.42% at YE 2019 to 1.56% at YE 2020 (with YE 2020 range between 0.4 % and 3.2%).

The increase in the Amortised Cost ECL allowance may be explained by the following:

- The average proportion of stage 2 gross credit exposures increased by 30% with a corresponding reduction of stage 1 proportion, stage 3 being stable on average.
- The overall stability of average stage 3 gross credit exposures hides wide changes ranging from a decrease of 50% to an increase of 40%.
- Going further would involve comparing write-off policies, SICR criteria, and the underlying nature and profile risk of portfolios.

Post-model adjustments (PMA) have significantly impacted the final ECL amounts, with significant differences from one bank to another:

- 20 banks have disclosed the amount of their post-model adjustments, amounting between 5% and 95% of their reported ECL charge at YE 2020.

We noted significant differences in the way that forward-looking is implemented (via scenarios and weightings), but there were overall improvements in the quality of the information disclosed

- Almost 100% of the sample provided quantitative information by scenarios such as weightings for each scenario, underlying parameters.
- All entities provided at least a basic element of sensitivity analysis, however, the disparity in the way these analyses were performed did not allow for any comparison between banks.

2. Sample and methodology

2. Sample and methodology

This study is based on audited information disclosed in the annual reports of participating banks, without taking into account any media releases, investor-oriented presentations or similar publications.

To favour comparability, we have chosen relevant indicators disclosed by a majority of the banks in the sample. Therefore, when a bank does not appear in a graph, it means that they did not disclose data relevant to that graph, in the documentation considered in this study.

Some figures presented, such as the ECL coverage ratio, have been calculated using input data from the annual reports. The detailed methodology for producing such figures is explained below each graph. It should be noted that comparisons should be taken with consideration, as the information provided by banks does not follow the exact same scope of instruments. In some cases, assumptions were made to increase the comparability of the data.

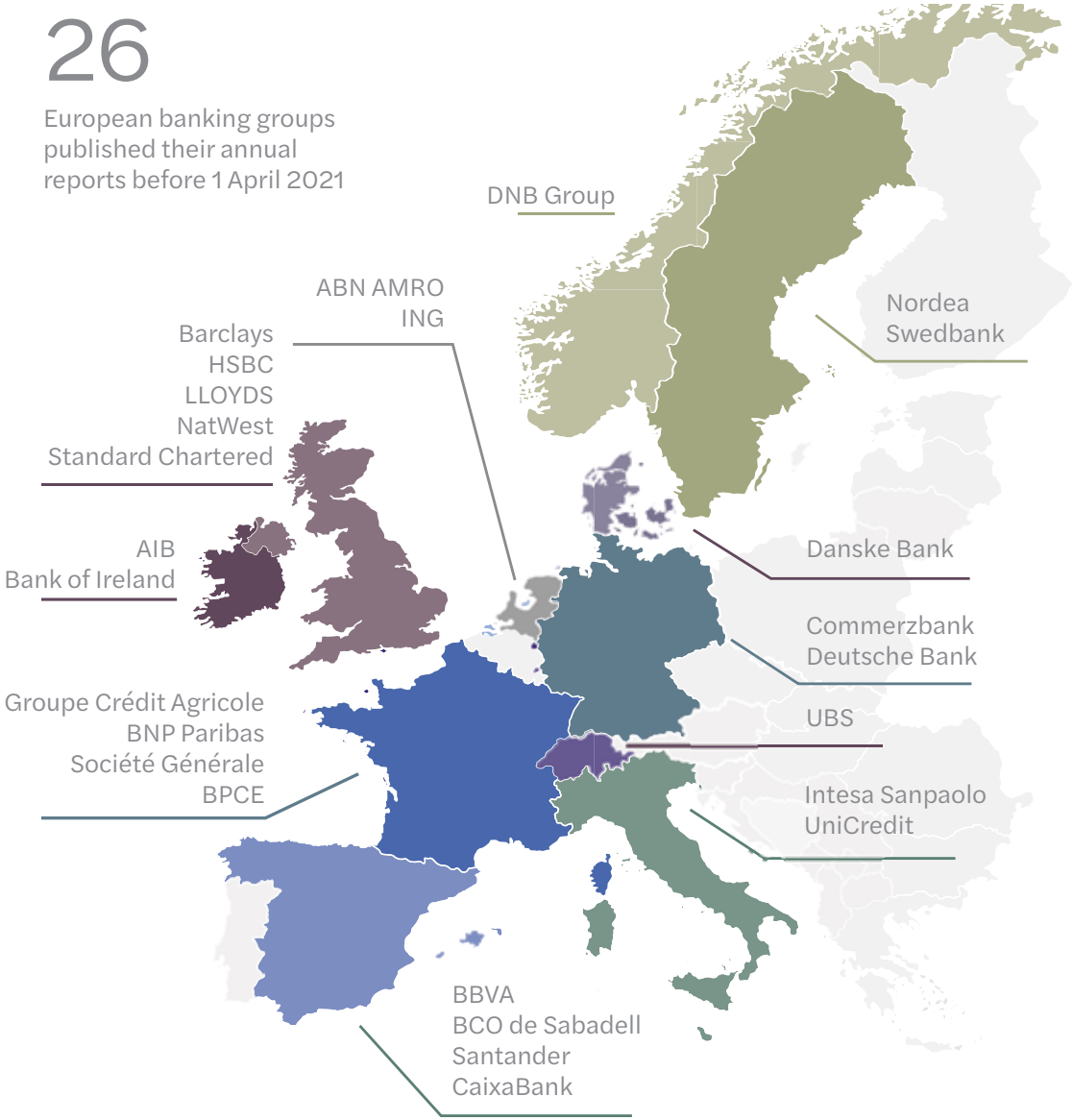
Each bank is represented by an alphanumeric code composed of two letters for its country, for instance, FR for France, and a number. When the sample presents only one bank in a country, to keep it anonymous, the country code is "O" for "other countries".

The graphs using figures that required specific calculations are indicated with the 'magnifying glass' icon, as seen on the left.

The comparison of quantitative findings should be examined with caution due to the differing natures and risk profiles of bank portfolios. Often, more granular additional information (e.g. by geographical area or by type of loan), would be necessary to fully understand the differences between the results of each bank.

26

European banking groups published their annual reports before 1 April 2021

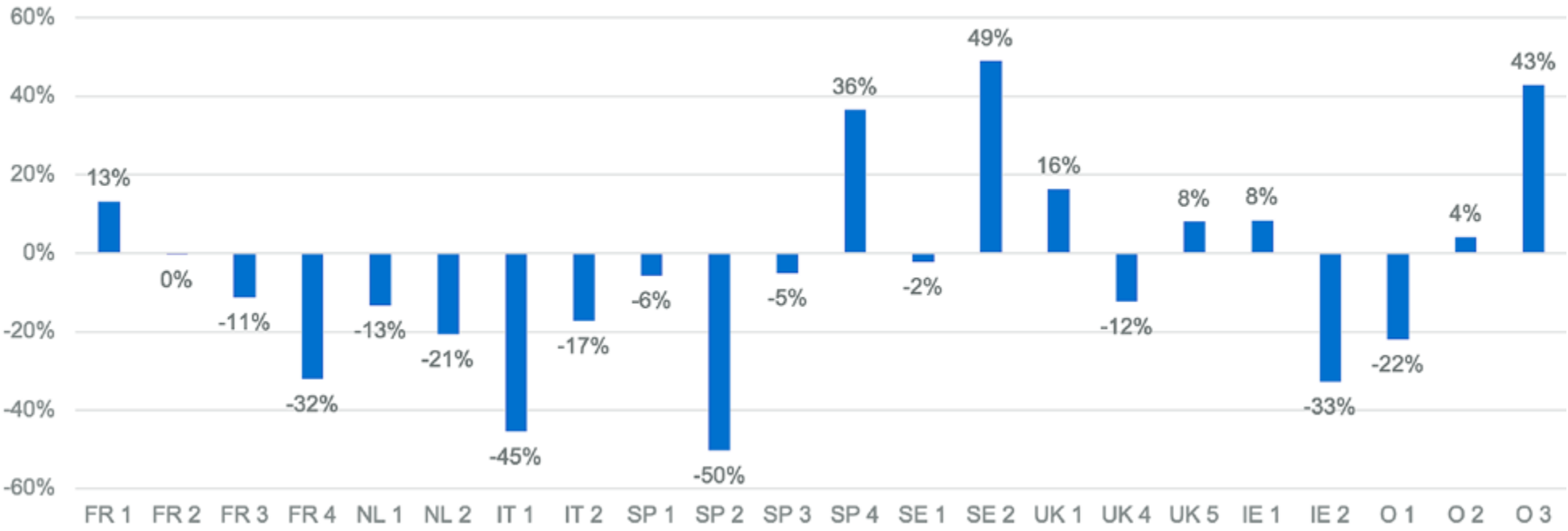


3. Key findings

3. Key findings

3.1 Change in operating profit or loss before ECL charge

Graph 1: Change in operating profit or loss before ECL charge var YE 2020 vs. YE 2019, in %



Insights

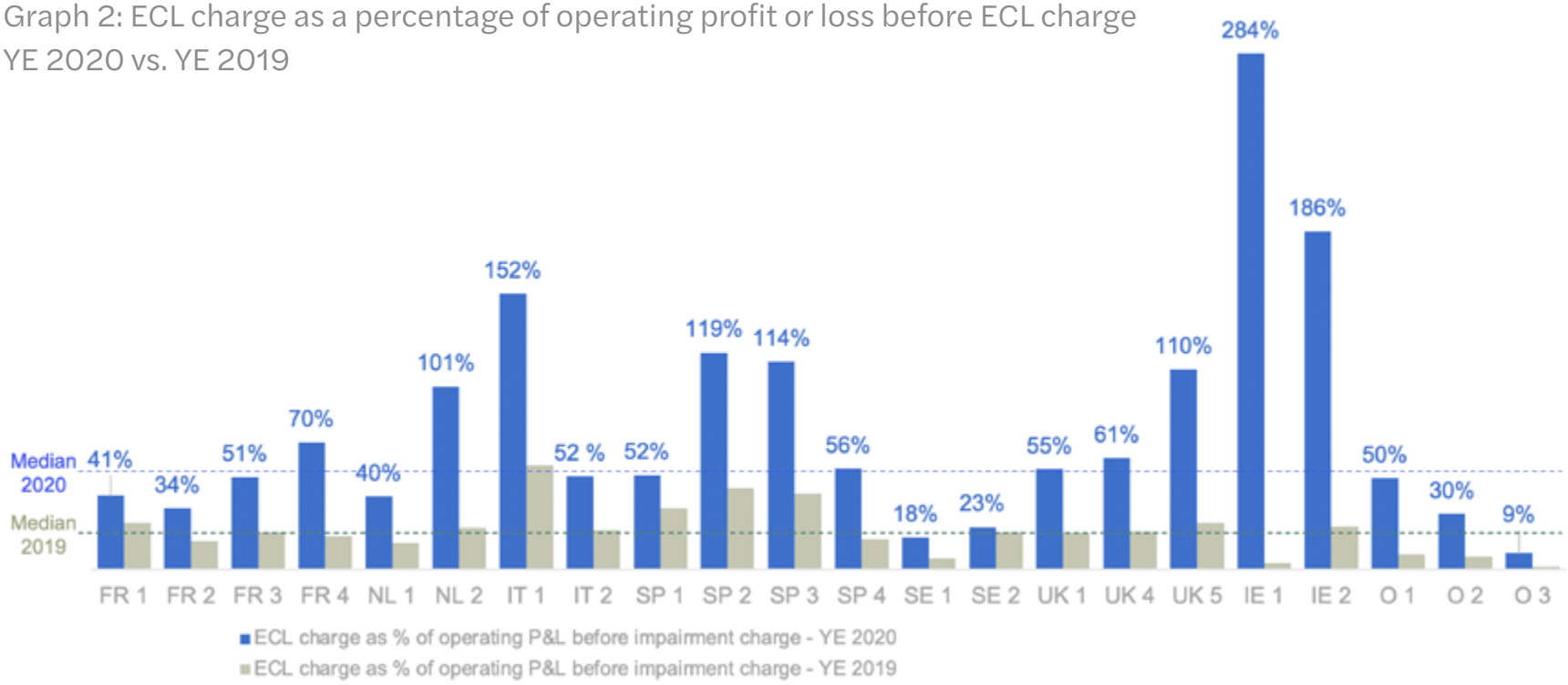
- Most of the banks (18 out of 26) experienced decreases in their operating profit or loss before ECL charge.
- Only eight banks in our sample showed a positive growth.
- Banks DE 1, DE 2, UK 2, UK 3 are not represented in this graph because their YE 2020 or 2019 values were negative.

The "operating profit before ECL charge" indicator has been computed with data available in the income statements of the banks in our sample. It includes salaries and other operating expenses, amortisation, depreciation or impairment charge for tangible and intangible non-financial assets (if any). It excludes 'non-operating' income or expense, such as the share in the income of associates and joint ventures, profit from disposal of non-financial assets and the ECL charge for the period. Given the differences in income statements of European banks, this indicator should be seen as **a broad measure of the net revenue of most operating expenses**, rather than a universal measure of net profitability before impairment (we cannot guarantee that the scope of this indicator is exactly the same in all of the banks in the sample).

3. Key findings

3.2 Share of ECL charge in operating profit or loss before ECL

Graph 2: ECL charge as a percentage of operating profit or loss before ECL charge YE 2020 vs. YE 2019



Insights

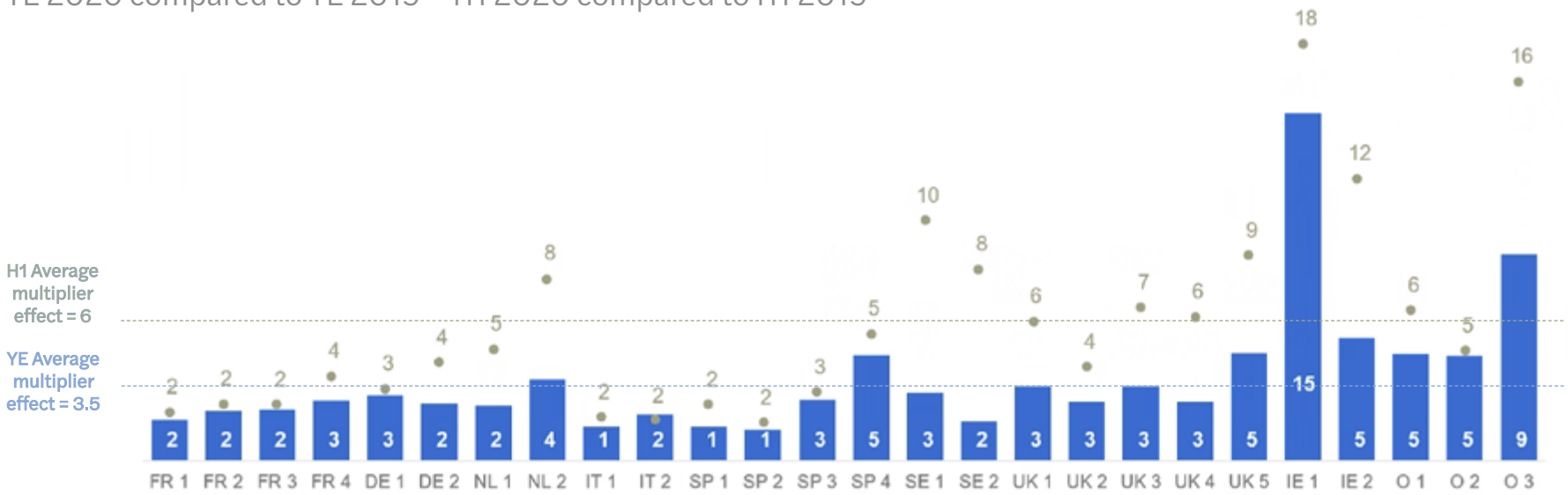
- The average ratio of ECL charge divided by the operating profit or loss before the ECL charge to 78% at YE 2020 (21% at YE 2019).
- At YE 2020, the median amounted to 53% (21% at YE 2019) with a range from 9% to 284%.
- Bank DE 1, DE 2, UK 2, UK 3 are not represented on this graph as either YE 2019 value or YE 2020 operating P&L were negative.

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

3. Key findings

3.3 Increase in ECL charge

Graph 3: Increase in ECL charge multiplier effect
YE 2020 compared to YE 2019 – H1 2020 compared to H1 2019



Insights

- The average multiplier effect of 3.5 at YE 2020 / YE 2019 remains significant even if it is lower than multiplier effect of 6 observed between H1 2020 / H1 2019.
- French, Italian and Spanish banks have had consistent impact throughout 2020, whereas the Dutch, Swedish and most UK banks have had more significant impact during H1 than the full year.
- The IE 1 multiplier effect is mainly explained by a very low level of ECL charges in 2019.

The data above should be interpreted with caution to avoid hasty conclusions.

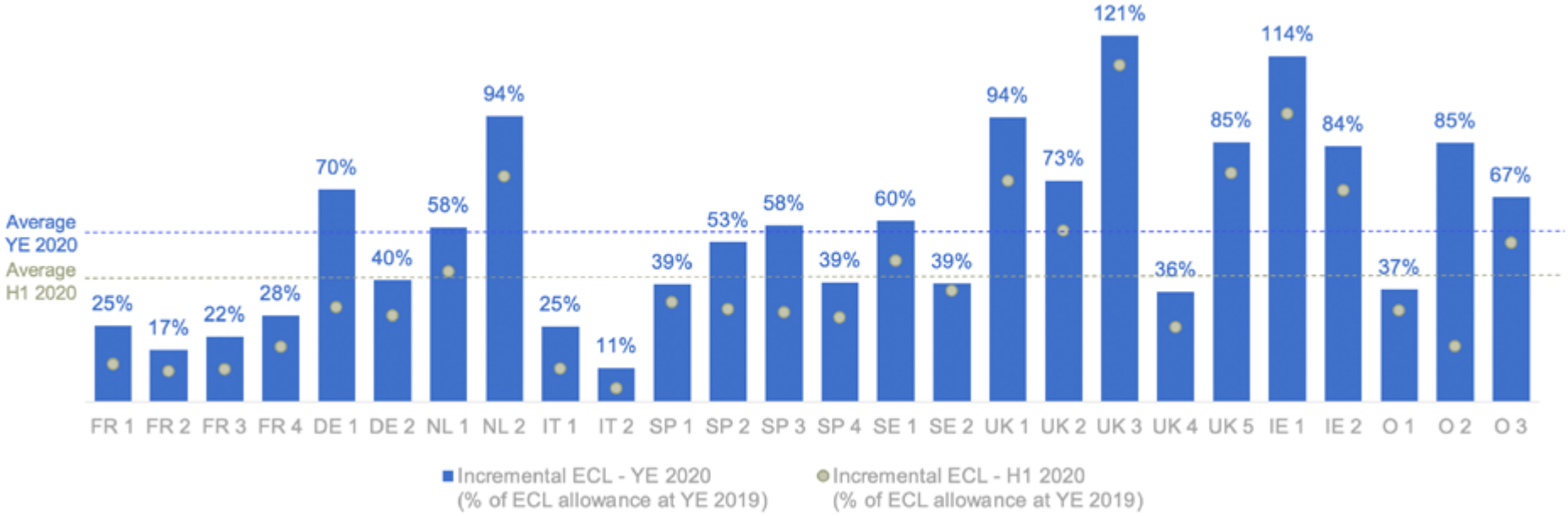
We used data available in the profit or loss statement as often banks isolate the ECL / fin. Instruments impairment charge within a single line of P&L (called "cost of risk" in France). However, at least one bank in our sample has included part of the ECL charge relating to off-balance sheet commitments 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 directly the financial statement information 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 non of such costs within the cost of risk line hinders comparison between banks.

3. Key findings

3.4 Incremental ECL (% of ECL allowance at YE 2019)

Graph 4: Incremental ECL
charge at YE 2020 an H1 2020 expressed as a % of ECL allowance at YE 2019



Insights

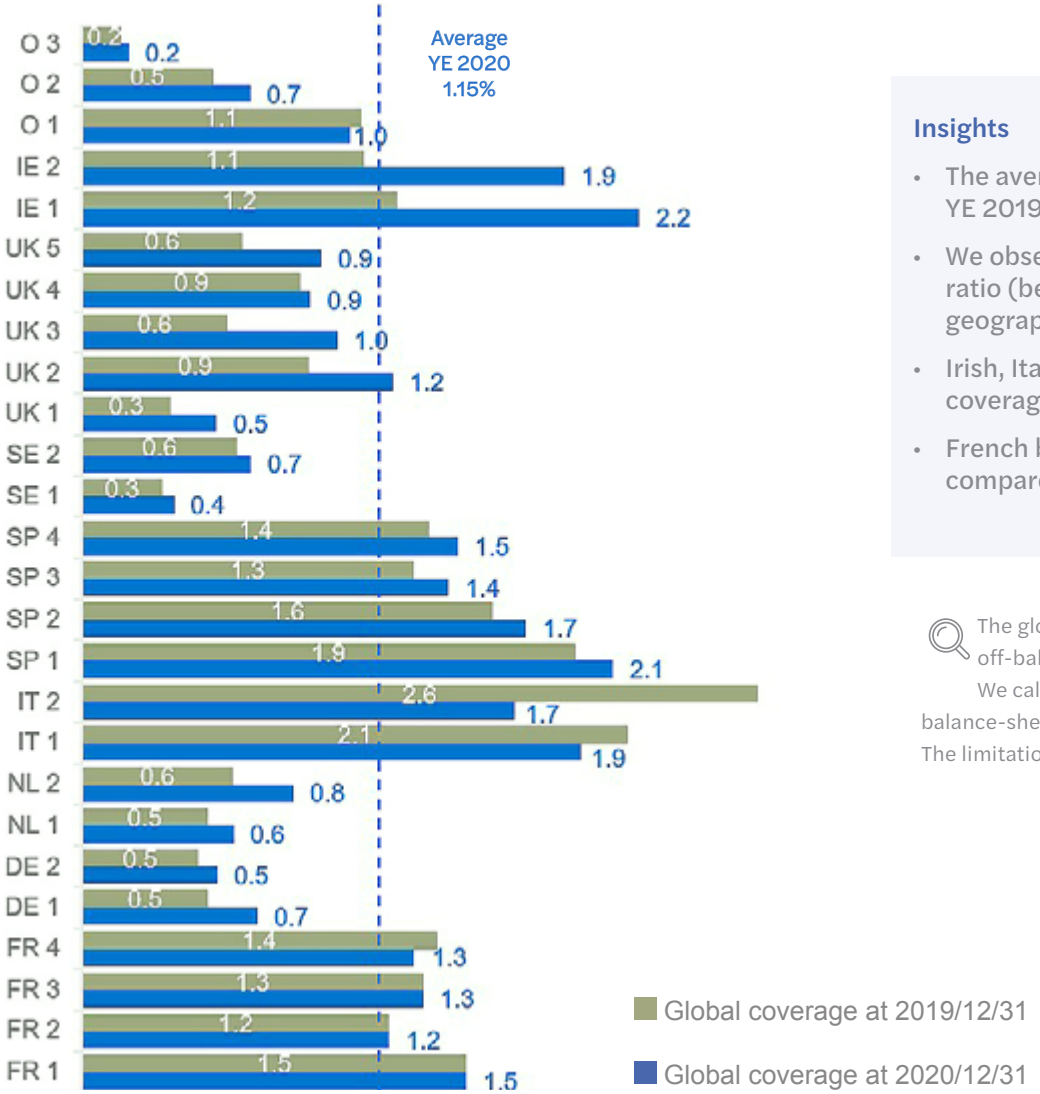
- The average incremental ECL was 57% at YE 2020 vs. 41% in H1 2020.
- There is a wide range of results: from 11% (IT 2) to 121% (UK 3).
- Banks with a ratio greater than (or close to) 100% at YE 2020 doubled (or almost doubled) their ECL allowances at YE 2019.
- Incremental charges of French and Italian banks were among the lowest.
- Almost all banks had an incremental ECL charge higher in H1 than in H2.

This graph presents the IFRS 9 ECL losses concerning assets at amortised cost, assets at FV-OCI and off balance sheet commitments and guarantees.

3. Key findings

3.5 Global ECL coverage ratio

Graph 5: Global ECL coverage ratio (%) YE 2020 vs. YE 2019



Insights

- The average global ECL coverage ratio was 1.15% at YE 2020 (1.03% at YE 2019).
- We observe a significant variance in the levels of global ECL coverage ratio (between 0.2% and 2.2%), with fairly strong consistency in each geographical area.
- Irish, Italian and to a lesser extent, Spanish, banks have a higher global coverage ratio than the others.
- French banks are close to the average range at YE 2020 and remain stable compared to YE 2019

The global ECL coverage ratio includes assets at amortised costs, assets at FV-OCI and off-balance sheet commitments and guarantees.

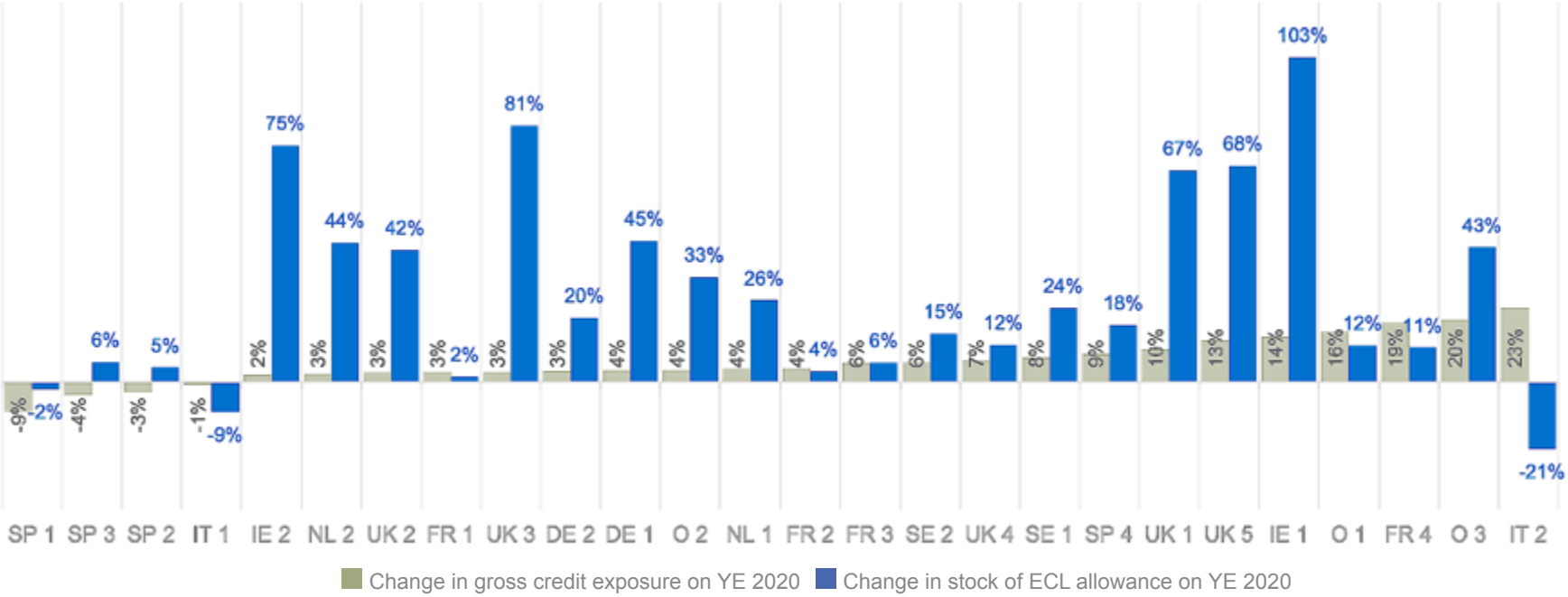
We calculated this coverage ratio for each bank by dividing the ECL allowance in the balance-sheet by the gross credit exposure (using the same data included in Graph 6).

The limitations of the data used to calculate these metrics are explained in the following page.

3. Key findings

3.6 Increase in ECL allowance and in gross credit exposure (GCE)

Graph 6: Increase (%) in gross credit exposure and in ECL allowance YE 2020 compared to YE 2019



Insights

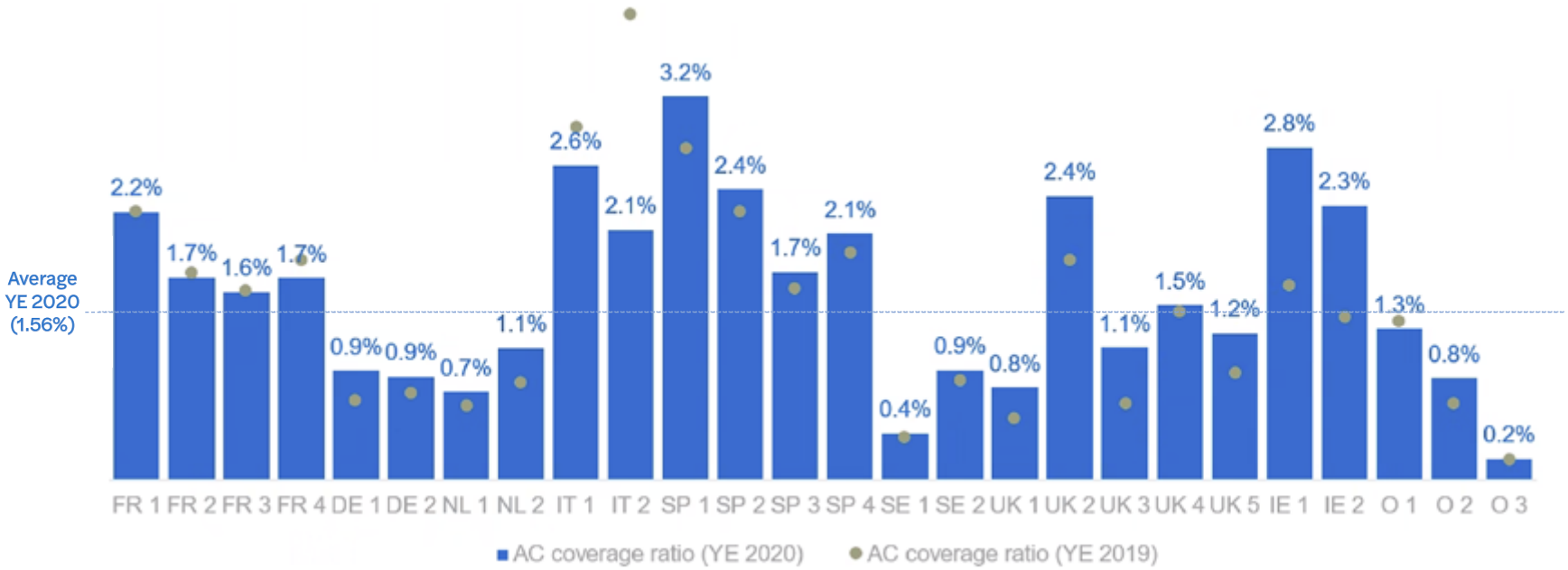
- The average increase in ECL allowance between YE 2019 and YE 2020 was 28% - whereas the average increase of gross credit exposures was 7%.
- GCE has increased for almost the entire sample (except three Spanish banks and one Italian bank).
- A small number of banks (mainly French) have increased their ECL allowance proportionally to their GCE.
- Almost half of the sample – notably UK, Dutch and Irish banks, showed increases in their ECL allowances that were significantly higher than those in their GCE.

Note: the definition of the (gross) exposure is not always provided and may differ from the definition of a "gross carrying amount" compliant with IFRS 9, which is intended to reflect the approximate notional amount before impairment (e.g. fair value rather than the gross carrying amount may be included for assets measured at FV-OCI with recycling to P&L). The gross credit exposure includes off-balance sheet commitments and guarantees, even if several banks did not disclose their real scope under IFRS 9 impairment. The figures in Graph 5, however, offer an approximation of the change in the volumes of instruments subject to the IFRS 9 impairment model.

3. Key findings

3.7 Focus on ECL coverage ratio for Amortised Cost (AC) assets

Graph 7: AC coverage ratio YE 2020 vs. 2019



Insights

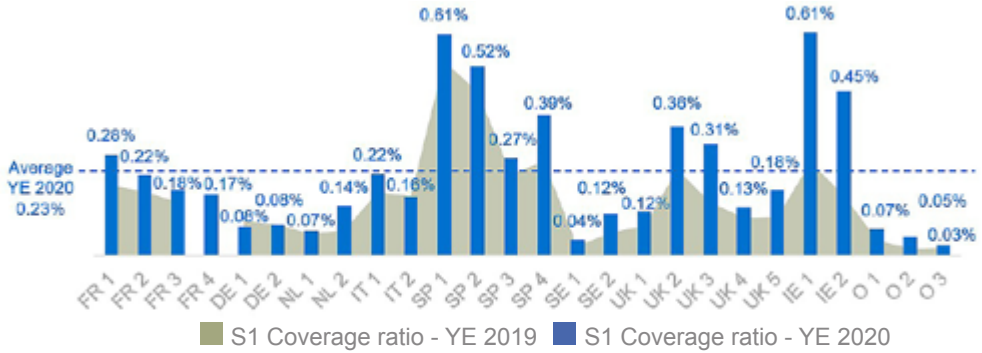
- The average AC coverage ratio at YE 2020 was 1.56%, within a range 0.4% to 3.2% (1.42% between 0.2% and 3.9% at YE 2019).
- Expanding the comparative analysis would require more detailed information by nature and the risk profiles of portfolios.
- At YE 2020, the average coverage ratio was 0.05% for assets at FV-OCI and 0.36% for off-balance sheet commitments and guarantees.

We computed the AC coverage ratio for each bank by dividing the ECL allowance of AC assets by the gross credit exposure of AC assets only. We have used the same methodology as described in the previous page and tried to be as consistent as possible given the information disclosed.

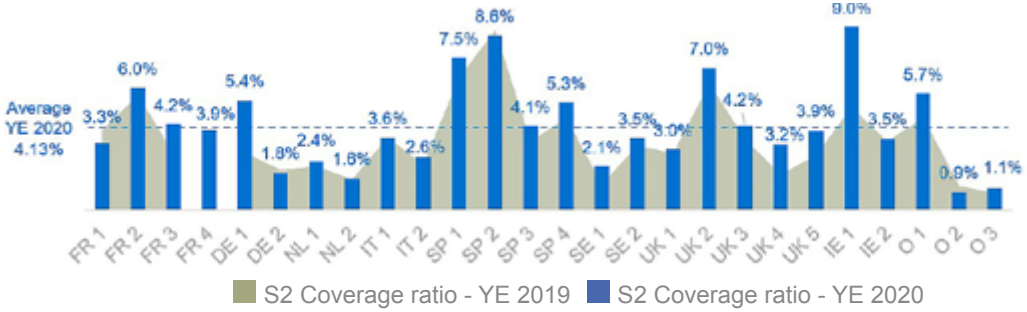
3. Key findings

3.8 AC coverage ratio broken down by stage

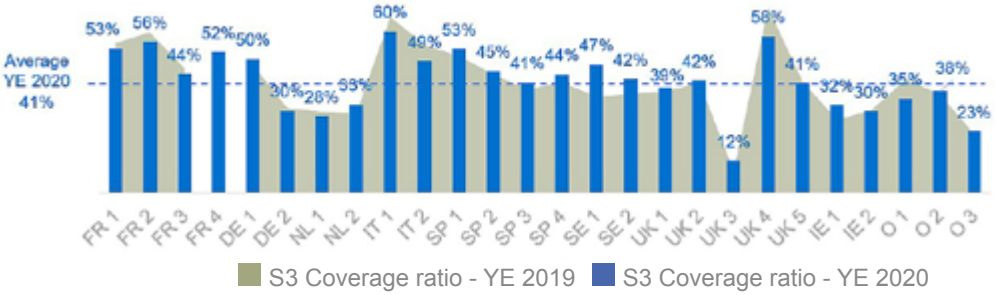
Graph 8.1: AC - Stage 1 coverage ratio



Graph 8.2: AC - Stage 2 coverage ratio



Graph 8.3: AC - Stage 3 coverage ratio



Insights

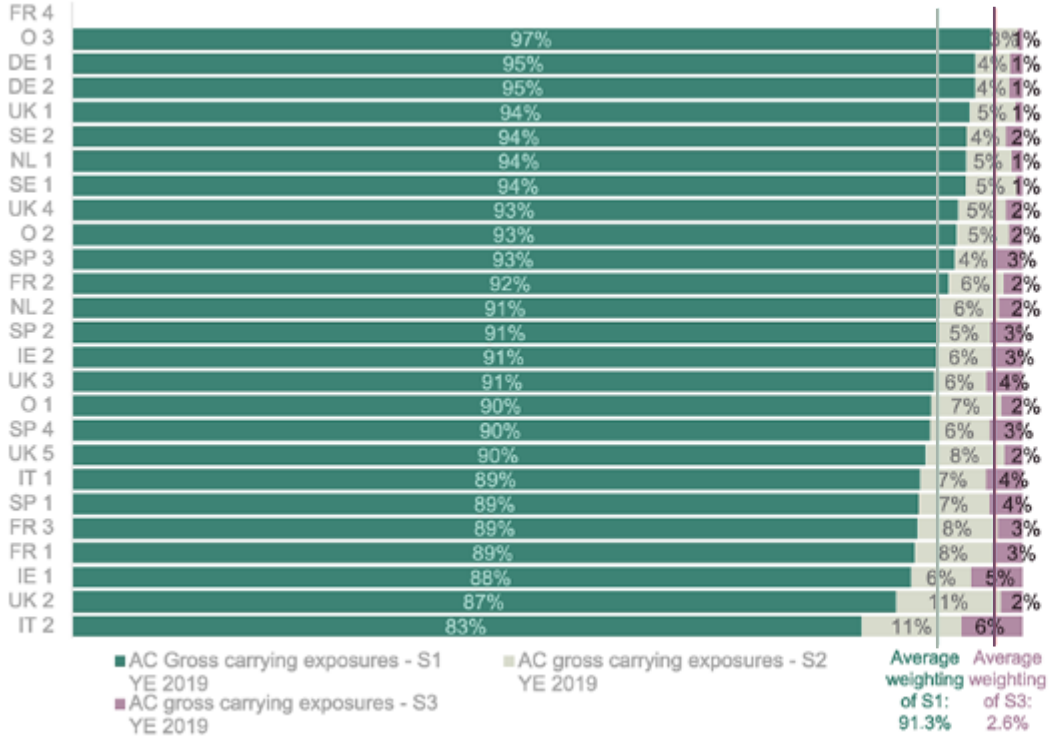
- Changes in coverage ratios by stage are heterogeneous within the sample.
- AC stage 1 ratio and AC stage 2 ratio were the highest among Irish and Spanish banks and have increased overall (average S1 moved from 0.16% to 0.23% and S2 from 3.46% to 4.13%).
- AC stage 3 coverage ratio decreased for 11 banks in the sample, but the average at YE 2020 (41.4%) remained close to 2019 finding (40.7%).

Some banks include POCI assets in their Stage 3 figures. In addition, several banks provided a breakdown by stage for most of their asset classes, but not necessarily all asset classes. The allocations by stage, therefore, are not directly comparable between banks. The comparability of Stage 3 weight may be further influenced by potentially different write-off policies.
The same methodology described in Graph 6 has been used for computing the ratio by stage. The limitations in relation to the data used to calculate these metrics are explained above.

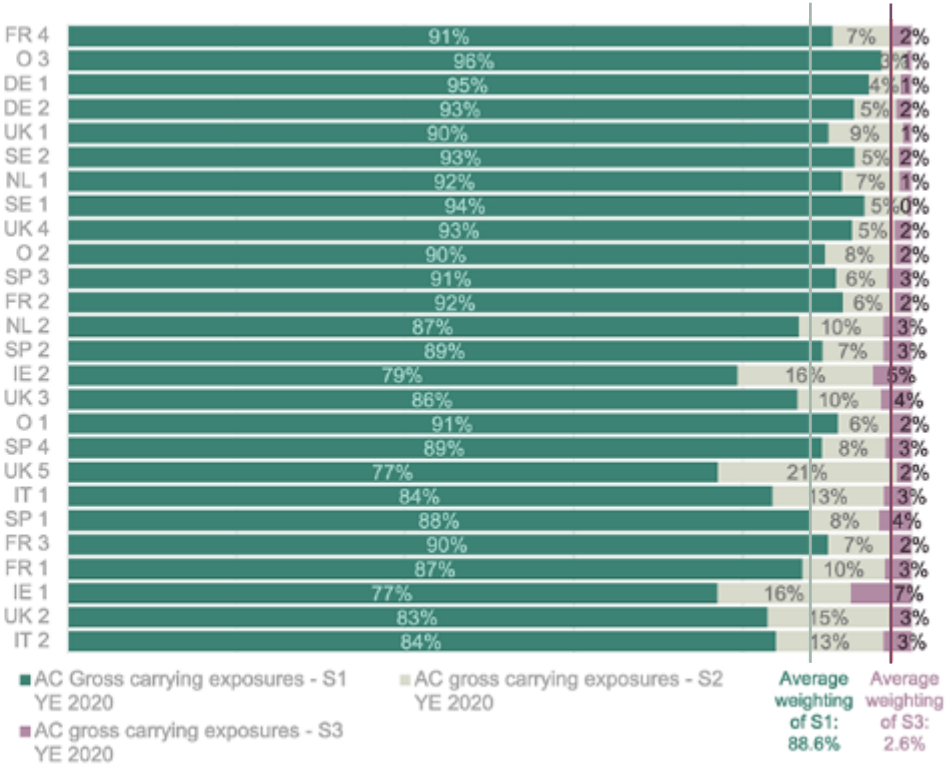
3. Key findings

3.9 Breakdown of AC gross credit exposures by stage

Graph 9.1: Allocation by stage of AC gross credit exposures at YE 2019



Graph 9.2: Allocation by stage of AC gross credit exposures at YE 2020

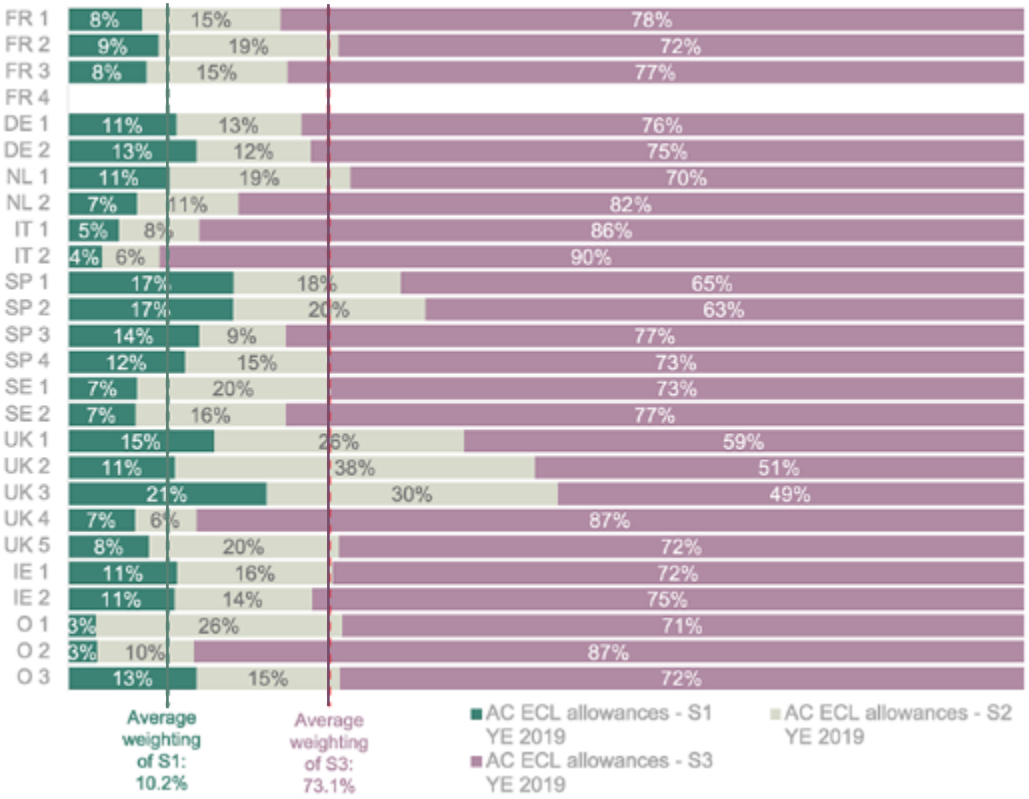


Some banks include POCI assets in their stage 3 figures. In addition, several banks provided a breakdown by stage for most of their asset classes, but not necessarily all asset classes. The allocations by stage, therefore, are not directly comparable between banks. The comparability of Stage 3 weight may be further influenced by potentially different write-off policies.

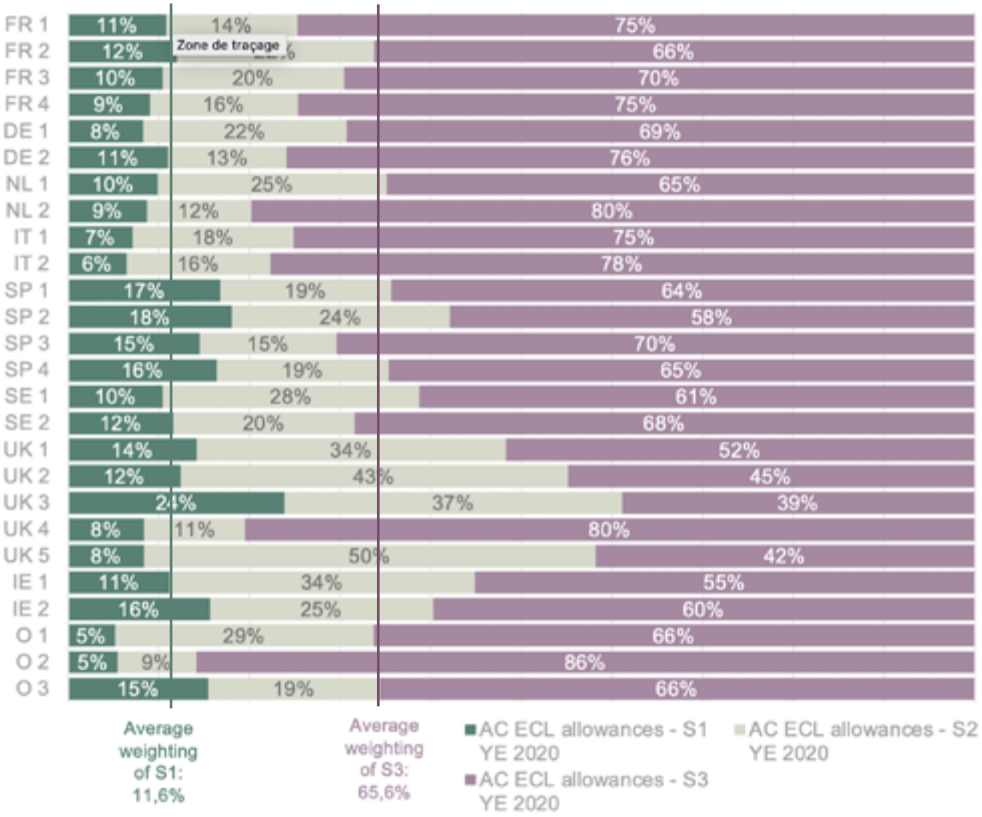
3. Key findings

3.10 Breakdown of AC ECL allowances by stage

Graph 10.1: Allocation by stage of AC - ECL allowances at **YE 2019**



Graph 10.2: Allocation by stage of AC – ECL allowances at **YE 2020**

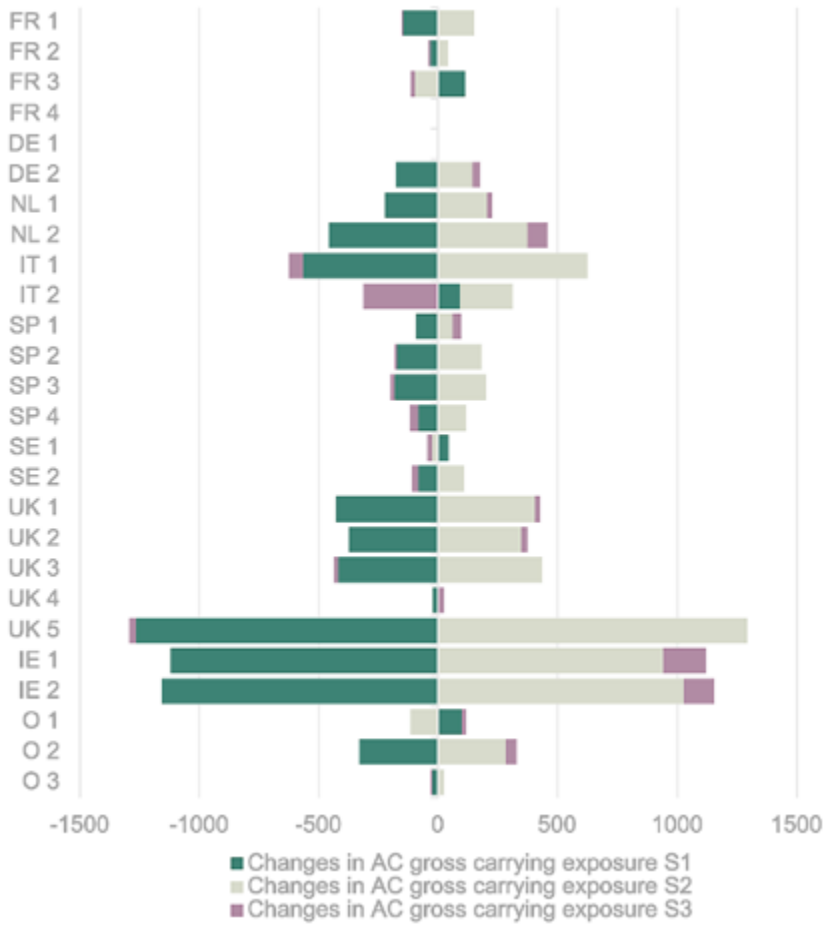


Some banks include POCI assets in the stage 3 amounts. In addition, several banks provided break-down by stage for most asset classes but not necessarily all asset classes. The allocations by stages therefore is not directly comparable across banks. The comparability of Stage 3 weight may be further influenced by potentially different write-off policies.

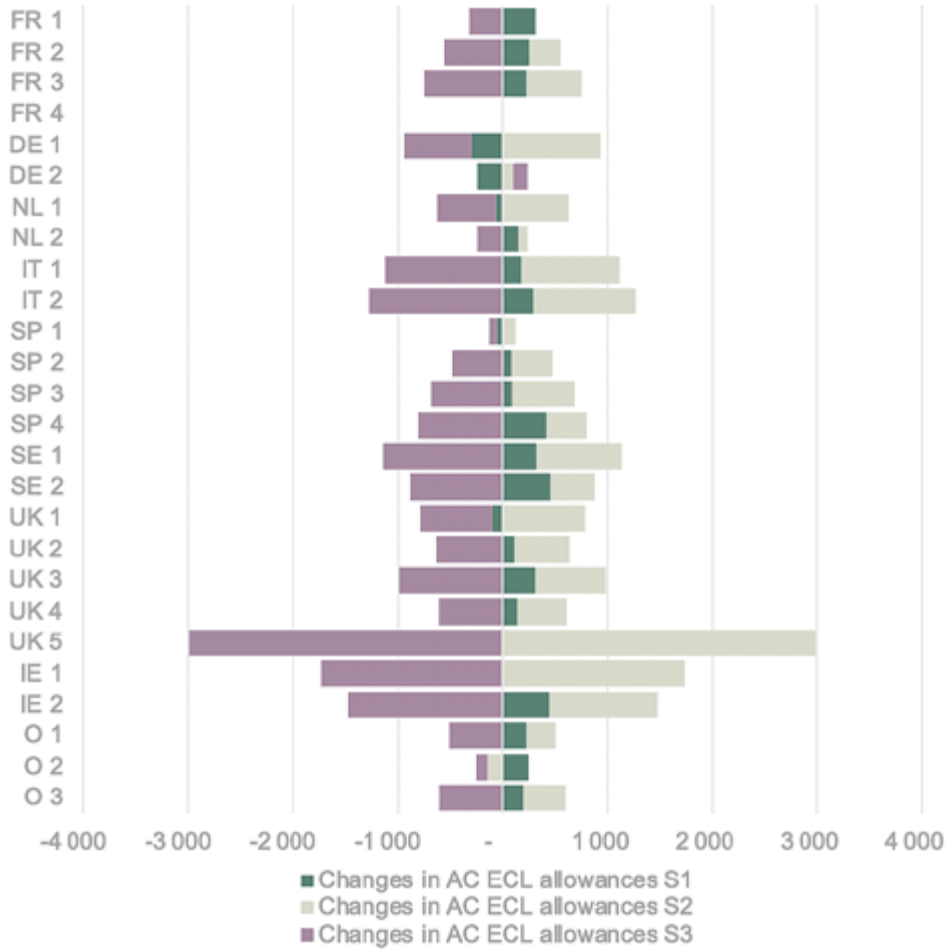
3. Key findings

3.11 Breakdown of changes in AC gross credit exposure and ECL allowances by stage

Graph 11.1: Changes in AC - GCE by stage
YE 2020 vs. YE 2019 (bps)



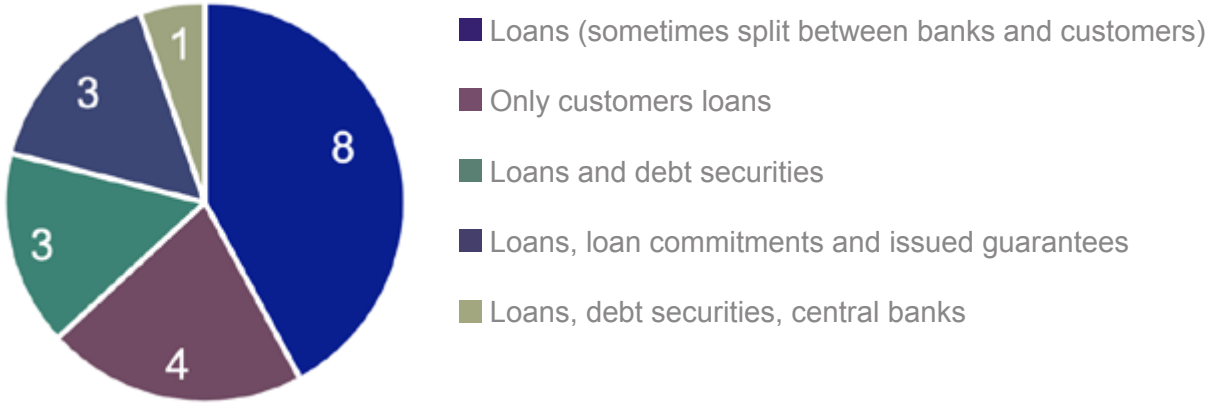
Graph 11.2: Changes in AC - ECL allowances by stage
YE 2020 vs. YE 2019 (bps)



3. Key findings

3.11 Data available on transfers between stages for AC assets

Graph 11.3: Scope of the reconciliation tables on transfers between stages for AC assets



Insights

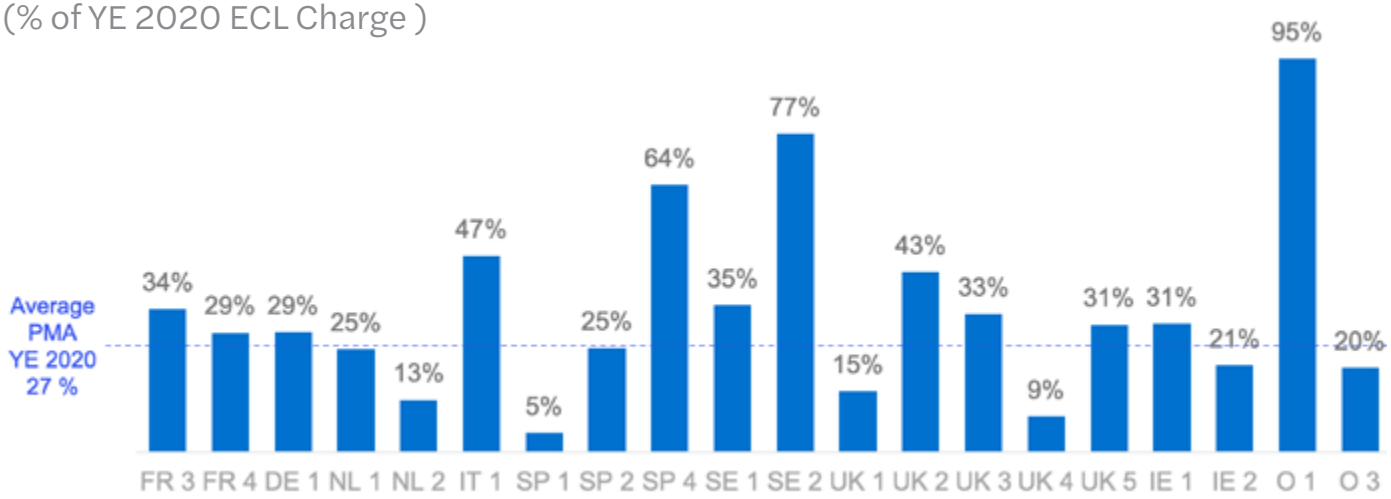
- 19 banks in the sample disclosed a reconciliation table from YE 2019 to YE 2020, both for the ECL allowance and the gross credit exposure. For other banks, information was not directly available and required calculations (at times including assumptions).
- The scope of the data used in disclosed reconciliation tables differs significantly, ranging from, "loans with customers" only to, "loans, loan commitments and issued guarantees."
- There is a lack of granularity and consistency of the information provided, which impairs comparability.

IFRS 7 requires a reconciliation from the opening balance to the closing balance of the ECL allowance, as well as an explanation detailing how significant changes in gross credit exposure contributed to changes in the ECL allowance.

3. Key findings

3.12 Post-model adjustments (PMA)

Graph 12.1: Extent of management overlays and post-model adjustments (% of YE 2020 ECL Charge)



25

banks disclosed overlay(s) and/or post-model adjustment(s)

20

banks disclosed their amounts

Insights

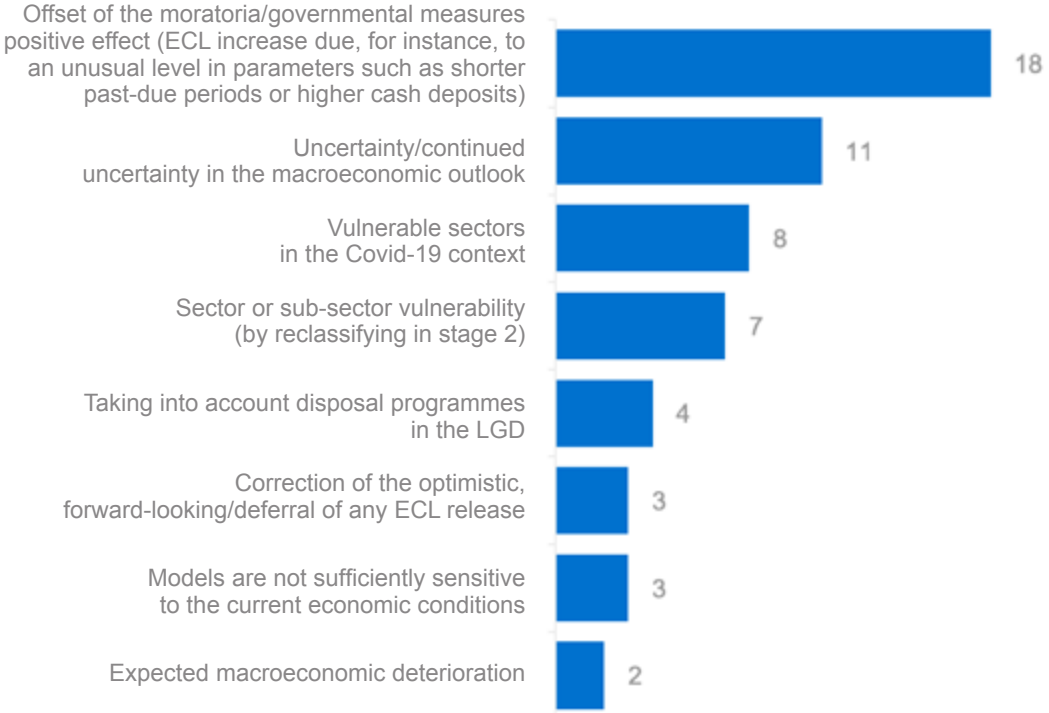
- The weighting of the PMA in the ECL charge at YE 2020 ranged from 5% to 95%.
- 11 banks had a PMA weight between 20% and 35%.
- There was no concrete "geographical" trend
- Six banks disclosed their PMA on a separate line in their reconciliation table from the ECL allowance between YE 2019 and YE 2020.

A post-model adjustment is an incremental ECL amount that increase (or decrease) the ECL amount issued by the IFRS 9 impairment models. As it isn't an IFRS 9 denominated concept, it can also be named as management overlay, top-level adjustment, management adjustment, additional adjustment, overlay provisions, etc. The amounts must be read cautiously as sometimes it has been difficult to make the difference between post-model adjustments and Covid adjustments.
Several banks disclosed having several post-model adjustments. Among these post-model adjustments, some were release of ECL.

3. Key findings

3.12 Most frequent underlyings of post-model adjustments (PMA)

Graph 12.2: Most frequent underlyings of the post-model adjustments YE 2020



Insights

- Many banks disclosed having several post-model adjustments among them (some may not be linked to the Covid-19 crisis).
- Some banks explained that they took the vulnerable sectors impacts into account through reclassification of assets from stage 1 to stage 2.

A post-model adjustment is an incremental ECL that increases (or decreases) the ECL issued by the IFRS 9 impairment models. As it isn't an IFRS 9 denominated concept, it can also be named as management overlay, top-level adjustment, management adjustment, additional adjustment, overlay provisions, etc. The amounts must be read cautiously as sometimes it has been difficult to make the difference between post-model adjustments and Covid adjustments.
Several banks disclosed having several post-model adjustments. Among these post-model adjustments, some were release of ECL.

3. Key findings

3.13 Sectors disclosed as vulnerable in the Covid-19 context

Graph 13: Sectors disclosed as vulnerable in the Covid-19 context

Insights

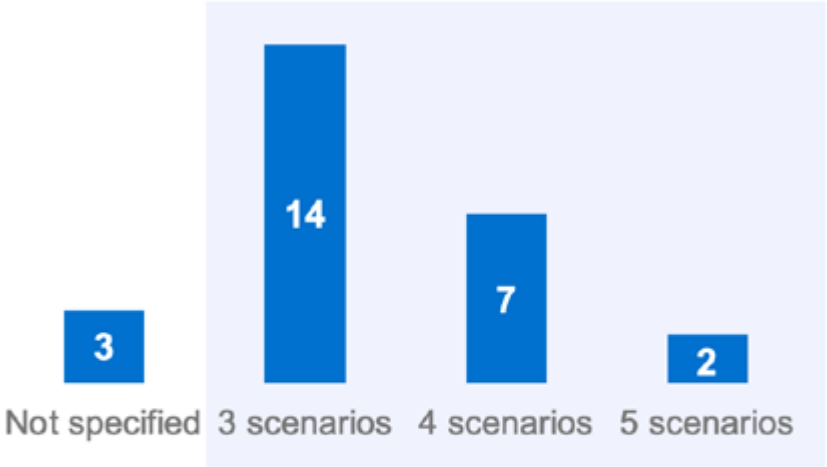
- Four banks did not provide explicit information on the sectors that they consider as vulnerable.
- This ranking is dependent on the underlying portfolios of each bank within the sample.

A vulnerable sector is a portfolio or sub-portfolio that has been disclosed as a sector specifically impacted by the Covid-19 crisis.

3. Key findings

3.14 An overview of macro-economic scenarios

Graph14.1: Number of macro-economic scenarios projected when calculating ECL, YE 2020



18

banks disclosed the weighting of each scenario at YE 2020 and YE 2019

Insights

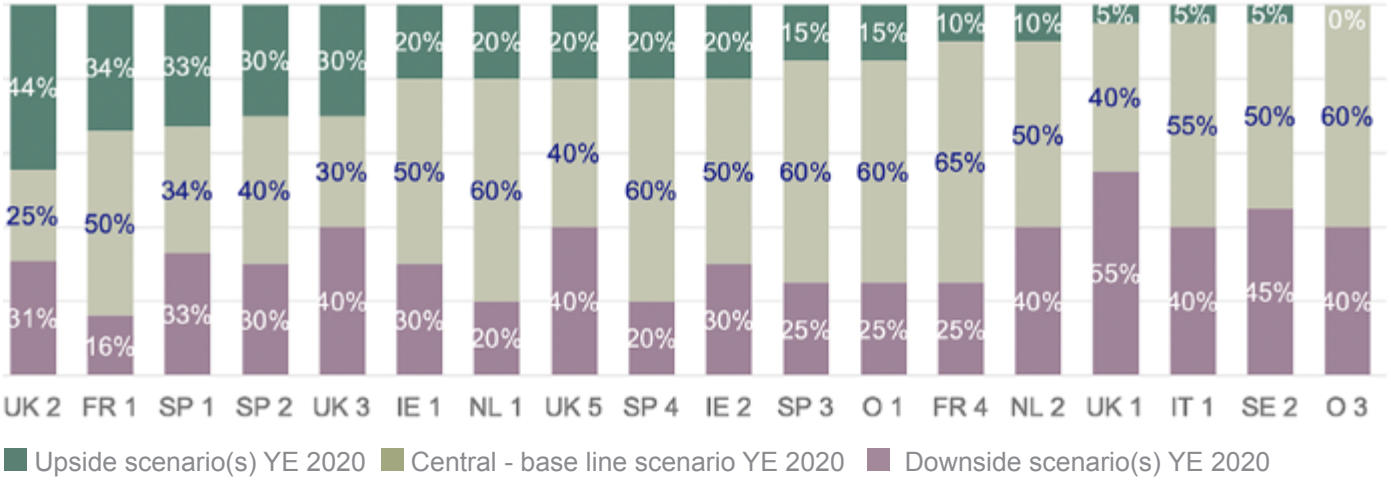
- The information disclosed has been improved significantly.
- Almost 100% of the sample gave quantitative information, such as the weighting identified for each scenario as well as underlying parameters
- Due to the wide range of approaches taken by each bank, there was limited benchmarking capacity.

Scenarios have been classified in 3 categories following the denomination disclosed: the downside scenario (or severe), the baseline scenario (or central) and the upside scenario (or optimistic). When the number of scenarios was above 3, leading to 2 downside scenarios for instance, the weightings of the 2 downside scenarios were added.

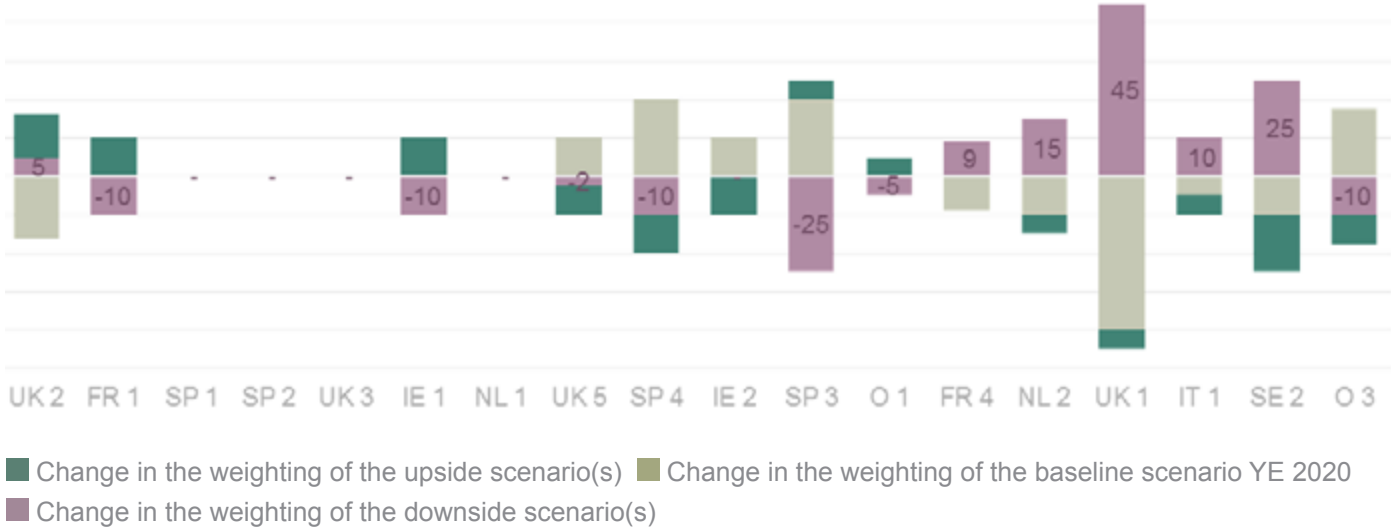
3. Key findings

3.14 Weightings of macro-economic scenarios

Graph 14.2: Weightings of the scenarios at YE 2020



Graph 14.3: Changes in the weightings of the scenarios YE 2020 vs. YE 2019 (var of %)



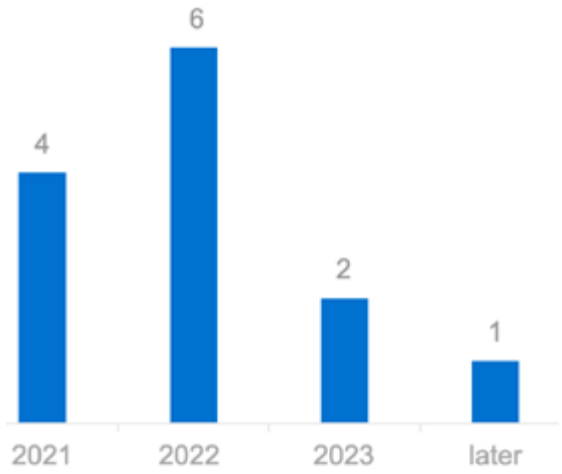
Insights

- The sample is quite heterogeneous regarding the weightings of each scenario (upside, baseline and downside) at YE 2020.
- Almost half of the sample weighted its upside scenario(s) at or above 20%.
- A high weighting of the upside scenario(s) does not imply a low AC - coverage ratio (YE 2020).

3. Key findings

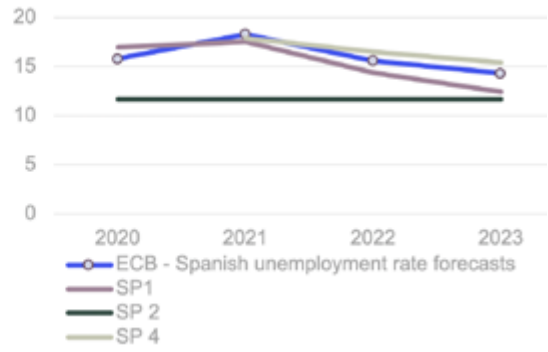
3.14 Understanding the underlying parameters of macro-economic scenarios

Graph 14.4: Recovery date of the economy at the pre-crisis level



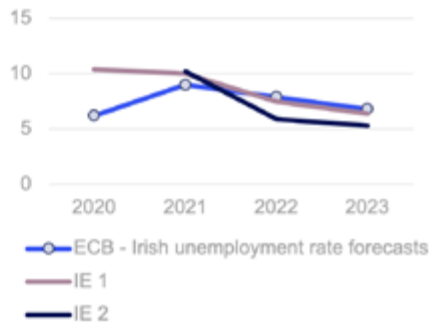
Graph 14.5: Spanish GDP in baseline scenario, comparaison between ECB and Spanish banks

Graph 14.6: Spanish unemployment rate in baseline scenario, comparaison between ECB and the forecasts of Spanish banks



Graph 14.7: Irish GDP rate in baseline scenario, comparaison between ECB and Irish banks

Graph 14.8: Irish unemployment rate, comparaison between ECB and the forecasts of Irish banks



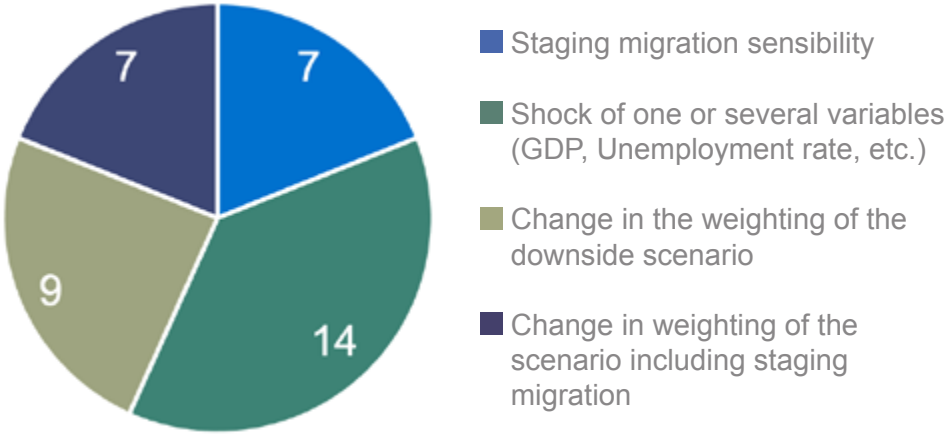
Insights

- **22 banks** provided qualitative information on the underlying parameters of their scenarios.
- All 22 banks disclosed their **Gross Domestic Product** and country **unemployment rate**. In addition other parameters such as real estate/ residential price, short-term and/or long-term interest rates were used. Among them, 21 banks disclosed quantitative information.

3. Key findings

3.14 Macro-economic scenarios: sensitivity analysis

Graph 14.9: Different methodologies



Insights

There was a significant improvement as 100% of the sample disclosed a sensitivity analysis (or similar).

However, it has been difficult to compare the analysis disclosed because:

- In some cases, the sensitivity analysis is summarised to just a few sentences, whereas in other cases, a detailed analysis over several pages is provided (with an additional split between geographical areas and/or portfolios).
- Methodologies often vary (see the graph 14.9).
- The scope of the sensitivity analysis may differ from the scope of the ECL (for instance: 'only stage 1 and 2' or 'only customer loans').
- The information given can be a percentage of either the ECL allowance or the ECL charge.

We define sensitivity analysis as a variation in the ECL linked to a change in the calculation model of the ECL allowance. This change could concern one or several variables in either one scenario or in the weightings of one or several scenarios. We acknowledge that this is a very broad definition.
As some banks disclosed several types of sensitivity analysis, the graph total higher than the number of banks that composed the sample –26.

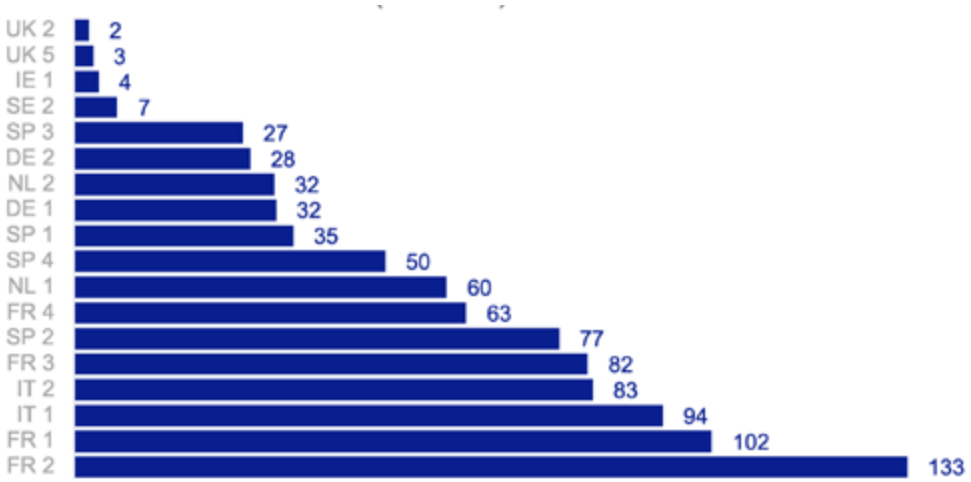
3. Key findings

3.15 TLTRO III

18

banks disclosed information about TLTRO III

Graph 15.1: Drawn amounts YE 2020 (billion €)



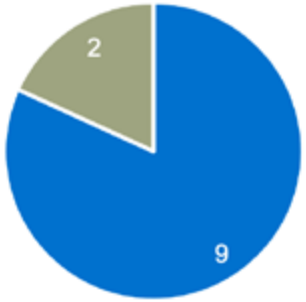
Insights

- The drawn amounts were disclosed by each of the 18 banks.
- **11 banks disclosed that they would benefit from the bonification because they comply or expect to comply with the required performance credit thresholds (amount of granted credits).**
- Among these 11 banks, all of them disclosed how they accounted for the additional ECB 50 bp bonification, and 8 banks clearly disclosed the standard that was applied (IFRS 9 or IAS 20). See figures below.

11

`banks disclosed that they would benefit from the bonification

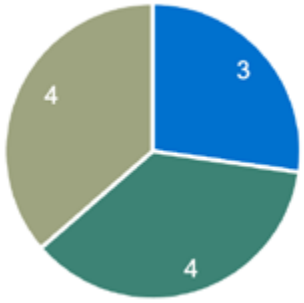
Graph 15.2: P&L impact of the additional 50 bp bonification



Over 1 year from June 2020 to June 2021

Over the estimated period to maturity

Graph 15.3: Which standard is mentioned in the disclosure?



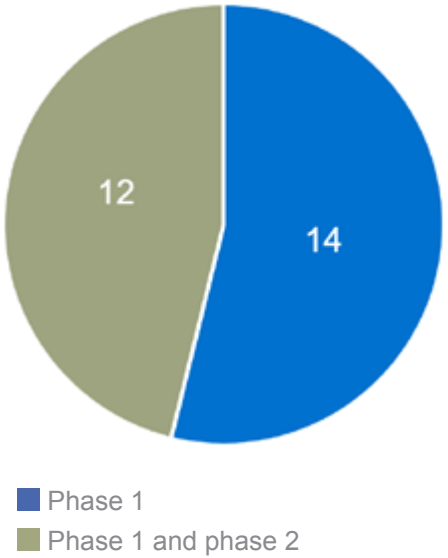
IAS 20 IFRS 9 None

The ECB's TLTRO III funding program offers long-term funding at attractive interest rates subject to the satisfaction of predefined lending performance thresholds.
We considered that IAS 20 was applied when mentioned explicitly or by using the "grant" terminology when qualifying the interest bonification.
We considered that IFRS 9 was applied when mentioned explicitly or when the interest rate was qualified as a market rate.
When relevant, the amounts have been converted in € with the exchange rates as of 31st December 2020.

3. Key findings

3.16 IBOR reform

Graph 16: IBOR phase applied



Insights

Across the sample,

- **23 banks** provide the notional value of derivatives in the scope
- 20 banks broke down the notional value of derivatives by creating a significant interest rate benchmark. Among them, 11 banks applied phase 1

For the 12 banks that chose to apply the Phase 2 amendments early on:

- They are mainly located in three countries: France (4), Spain (3) and UK (4).
- 9 banks disclosed the notional value of derivatives and carried amounts of non-derivatives assets/liabilities). Among them, 8 banks gave a breakdown of their significant interest benchmark rate.

As a reminder: the Phase 1 amendments consider uncertainties generated by the reform on the hedging relationships. Their mandatory application date was 1 January 2020.

The Phase 2 amendments were applied when financial instruments had been modified to take into account the replacement of an old benchmark rate (e.g. EONIA) with a reference rate (e.g. €STER). They became mandatorily applicable on 1 January 2021, with the possibility of an early application. We consider that the Phase 2 amendments were applied early in cases where the information was explicitly disclosed.

Contacts

Coordination

Vincent Guillard
Partner
+33 1 49 97 65 52
vincent.guillard@mazars.fr

Florence Michel
Senior manager
+33 1 49 97 60 00
florence.michel@mazars.fr

Germany

Dirk Driesch
Partner
+49 40 288 01 3330
dirk.driesch@mazars.de

Heike Hartenberger
Senior manager
+49 69 967 65 1629
heike.hartenberger@mazars.de

Ireland

Michael Tuohy
Partner
+353 1 449 64 33
mtuohy@mazars.ie

Willy Oppermann
Senior manager
+353 1 512 5544
WOppermann@mazars.ie

Spain

Carlos Marcos
Partner
+34 915 624 030
carlos.marcos@mazars.es

Maria Cabodevilla
Partner
+34 915 624 030
maria.cabodevilla@mazars.es

France

Alexandra Kritchmar
Partner
+33 1 49 97 64 19
alexandra.kritchmar@mazars.fr

Mathieu Ribes
Partner
+33 1 49 97 60 00
matthieu.ribes@mazars.fr

Italy

Silvia Carrara
Partner
+39 34 5843 23 36
Silvia.Carrara@mazars.it

Manuel Bellomi
Manager
+ 39 34 0840 28 76
manuel.bellomi@mazars.It

Netherlands

Carel Van Oldenbeek
Partner
+31 88 277 24 67
Carel.vanOldenbeek@mazars.nl

Donny Bommezijn
Manager
+31 6 11 22 07 51
donny.bommezijn@mazars.nl

United Kingdom

Xavier Larrieu
Partner
+44 78 88128 3791
xavier.larrieu@mazars.co.uk

Pauline Pelissier
Director
+44 0 788 128 3770
pauline.pelissier@mazars.co.uk

Mazars is an internationally integrated partnership, specialising in audit, accountancy, advisory, tax and legal services*. Operating in over 90 countries and territories around the world, we draw on the expertise of more than 42,000 professionals – 26,000+ in Mazars' integrated partnership and 16,000+ via the Mazars North America Alliance – to assist clients of all sizes at every stage in their development.

*where permitted under applicable country laws

www.mazars.com

mazars