BANK NEWS

Mazars banking newsletter / N°12

SPECIAL ISSUE : AQR

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EDITORIAL

For nearly a year now, more than 100 large European banks have been subject to an unprecedented assessment exercise considering its scope and resource requirements.

Undoubtedly, most Bank News readers have been impacted, directly or indirectly, by the Asset Quality Review and will continue to be dedicated to meeting the European authorities' stress test demands in the coming weeks.

Therefore, this issue doesn't aim to explain the process of the exercise but instead shed light via diverse contributions - from auditors, analysts, consultants and academics – on the Comprehensive Assessment in preparation of the Single Supervisory Mechanism. However, this might not necessarily be a one-shot exercise. There is a possibility that the ECB could require banks to re-execute the exercise again in the future.

THE BANKING INDUSTRY TRACKER

PERFORMANCE OF THE MAIN EUROPEAN BANKING GROUPS IN 2013

31.12.2013 in M€	Total Assets		Operating Income		Risk-Weighted Assets		Credit risk		Cost-income ratio		Core Tier 1	
HSBC	1937.0	-1%	48.7	-5%	792.3	-3%	4.4	-30%	60%	3%	14%	1%
BNPP	1800.1	-6%	38.8	-1%	560.0	1%	4.1	3%	67%	1%	10%	-2%
Crédit Agricole	1706.3	-7%	31.2	1%	477.0	-1%	4.0	-14%	63%	3%	13%	1%
Deutsche Bank	1611.0	-20%	31.9	-5%	300.0	-10%	2.1	20%	89%	2%	13%	1%
Barclays	1574.0	-12%	32.6	12%	425.8	-8%	3.6	-8%	79%	5%	13%	2%
Société Générale	1235.3	-1%	22.8	-1%	315.5	-3%	4.1	4%	72%	-1%	11%	1%
RBS	1232.9	-22%	23.3	10%	462.4	-16%	9.9	60%	73%	-14%	9%	-2%
BPCE	1123.5	-2%	23.1	3%	409.5	7%	2.0	-7%	70%	1%	10%	0%
Santander	1115.6	-12%	39.8	-9%	489.7	-12%	11.4	-16%	**50%**	-4%	12%	1%
Moyenne	1101.9	-10%	24.7	0%	348.8	-2%	4.1	-4%	66%	2%	13%	1%
ING	1081.0	-8%	15.3	7%	83.0	14%	0.6	-74%	57%	4%	12%	0%
Lloyds TSB	1016.0	-9%	21.7	2%	316.5	-15%	3.5	-47%	51%	5%	14%	2%
Unicredit	845.8	-9%	24.0	-4%	423.7	-1%	13.7	47%	62%	-2%	10%	-1%
UBS	822.7	-20%	22.5	9%	185.7	156%	0.1	2%	88%	18%	22%	3%
Crédit Suisse	710.8	-6%	21.0	8%	223.0	22%	0.1	3%	80%	9%	16%	0%
Nordea	630.4	-6%	9.9	-1%	209.2	-2%	0.7	-17%	**51%**	0%	15%	2%
BBVA	599.5	-6%	21.4	-5%	323.6	-2%	6.4	-26%	52%	-1%	12%	1%
Commerzbank	550.0	-14%	9.3	-6%	190.6	-8%	1.7	5%	73%	-2%	13%	1%
KBC	241.3	-6%	7.5	-2%	90.5	-10%	1.8	50%	51%	3%	14%	2%

MAZARS' INSIGHTS

EUROPEAN BANKS MAY FACE BAIL-IN POST STRESS TEST

BY GREGORY MARCHAT - HEAD OF BANKING CONSULTING, MAZARS UK

ECB vice president Vitor Constancio in a speech on 12 May emphasised that bail-in would be the preferred option for any banks requiring recapitalisation after completion of the ECB's Comprehensive Assessment of euro-area banks this year, but left open the possibility that recourse to state aid remained on the table.
The Comprehensive Assessment includes an asset quality review and stress test, the latter being coordinated by the European Banking Authority on an EU-wide basis.
The EBA recently released its specifications for conducting the stress tests, which aim to test the resilience of the European banking system to a range of challenging macroeconomic scenarios.
The outcome of the exercise will be critical to investor confidence in European banks and the credibility of the new setup of European banking supervision as the ECB begins supervision at the end of the year.

• The stress scenario is more challenging than previous European stress tests, which failed to restore investor confidence – but it is less severe than the scenarios that the UK and US authorities are subjecting their banks to.

• However, the fact that an asset quality review is also taking place means that there can be greater confidence in the results of the stress tests.

• Bail-in will be the first option for any bank that fails the baseline scenario of the stress test, which will ease the sovereign bank nexus – although state aid remains on the table.

• Yet challenges to smooth communication of the stress test results may arise – although the authorities will be keen to avoid provoking adverse market reactions.

STRESSFUL ENOUGH ?

The aim of a stress test is to boost the confidence of both investors and regulators in the resilience of banks to a potential future downturn in economic circumstances. That means the adverse scenario should assume sufficiently tough conditions. On previous occasions, a number of banks who 'passed' the stress tests then went on to actually fail and need to be bailed out:
• Two of Ireland's biggest banks passed the stress tests in 2010, only months before the sector collapsed.

• In 2011, Spain's Bankia, Franco-Belgian Dexia, and Dutch SNS Reaal passed – only to later have to be rescued.

This had the effect of losing credibility in the stress testing process and failing to reassure investors. The EBA also had its reputation damaged as a result. .

The details of the 2014 test, published on 29 April, is designed to show whether or not banks would still have enough capital to remain solvent after facing simultaneous shocks in the stock, property and bond markets. The tests have been made more rigorous than the EBA's previous effort in 2011 – yet the scenarios fall short of those conducted by the US and the UK:

• The adverse macroeconomic scenario requires banks to be able to cope with a cumulative loss of 2.1 percent of economic output over three years, whereas it fell by only 0.4% over two years in the 2011 tests. This would push up unemployment to at least 13% and send house prices down by 20% on average, triggering defaults on loans held by banks.

• However, put into perspective, the recession that banks are expected to deal with is relatively modest: the euro area economy would shrink less than 1% this year and 1.4% next year. The 2.1% cumulative decline in economic output over three years is less than the stress applied by the US tests, a 4.75% decline over fifteen months. The UK stress test is much tougher.

• In addition, there is no deflation in the EU adverse scenario. This points to the difficulties of constructing realistic scenarios, without affecting expectations. The European Systemic Risk Board, which designed the adverse scenario, is a collection of central bank governors, who are keen not to send any signal about their expectations of a deflationary scenario emerging in the euro area.

2,1%

CUMULATIVE LOSS OF ECONOMIC OUTPUT BANKS SHOULD BE ABLE TO COPE WITH OVER 3 YEARS.

EURO ZONE STRESS TEST IS RELATIVELY MODEST : US AND UK TESTS ARE MUCH TOUGHER.

There are a number of other factors which suggest the stress tests will be different this time around and more likely to have a successful outcome:

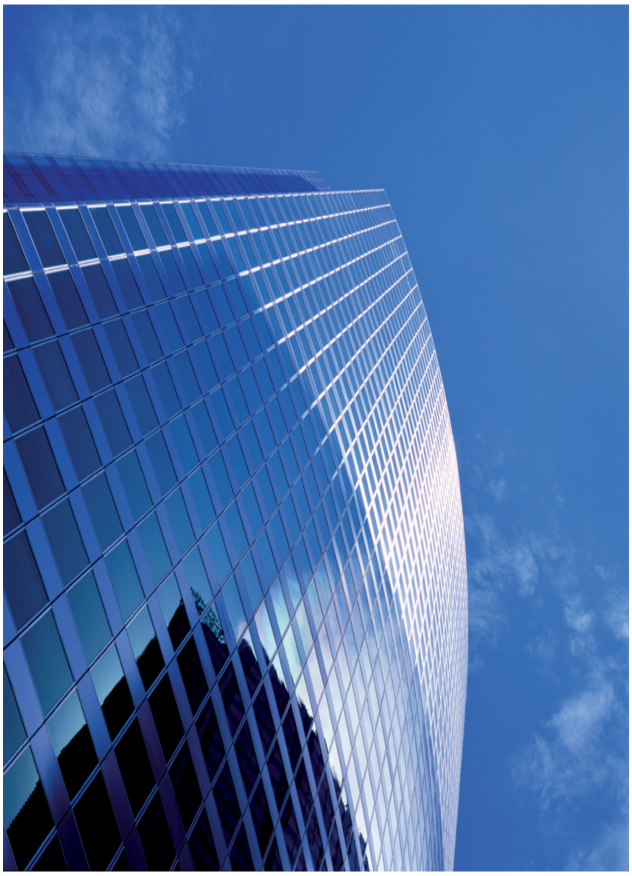
Comparability. The EBA is emphasising that their focus on the stress tests will be on consistency and comparability of results. Indeed, one of the challenges the EBA faced in conducting the stress tests in 2011 was that the EBA had a coordinating role, while the national competent authorities were responsible for conducting the tests. This meant that the results weren't comparable – and there was no centralised quality control on the data received from banks, while national regulators had an interest in protecting their own banks from scrutiny. This is partially mitigated this time around. The main competent authority is now the ECB, which is conducting an asset quality review on the biggest banks in the euro area. The results of the asset quality review will form the starting point for the stress tests. This means greater consistency will be achievable across the EU and particularly should provide a sounder basis for the exercise in the euro area. And people will be able to have greater confidence in the credibility of the tests. The EBA last time was just coordinating the stress tests of national regulators, and had no ability to evaluate the data quality.

• **Market conditions.** The 2011 stress tests were conducted during a period of acute market stress. Since then, markets have recovered, banks have deleveraged overextended balance sheets and have recapitalised on a large scale, and there is a stronger appetite for bank equity and confidence in their soundness. In addition, markets have regained confidence in government bonds in the troubled euro-area periphery. This makes it less likely that an unexpected shock could occur after the tests.

• **Backstop.** One reason that the 2011 stress tests lacked credibility in the eyes of the market is because there was no credible fiscal backstop in place to bail out any banks failed. This created an incentive for regulators to ensure that no bank fails. In contrast, the Fed stress tests had a backstop, which contributed largely to their credibility. There is greater clarity this time around about recapitalisation measures, as European authorities have now moved towards an approach of creditor bail-in for banks with a capital shortfall. The Bank Recovery and Resolution Directive requires a bail-in of shareholders and creditors equal to 8% of total liabilities of a given bank from 2016. However, this will not apply to recapitalisations in the context of the Comprehensive Assessment. Instead, the bail-in rules that will be in place result from the European Commission's communication of July 2013, which that any public support of banks considered as state aid should be preceded by a bail-in of bank shares, capital hybrids and subordinated debt. However ECB vice president Vitor Constancio recently indicated that exceptions to this may be required in specific cases at the end of the Comprehensive Assessment. This leaves open the possibility of bailouts by individual member states. There therefore is a degree of uncertainty over what the mechanism will be for addressing individual banks that are in need of recapitalisation after the conclusion of the Comprehensive Assessment. Yet it is clear that private bailing-in is now the preferred option among European policymakers. What is clear is that some banks will have to fail the tests in order for them to be perceived as credible.

8%

TOTAL LIABILITIES OF A GIVEN BANK SHAREHOLDERS AND CREDITORS ARE REQUIRED TO BAIL-IN FROM 2016.



SEQUENCING AND COMMUNICATION

However, the problems around institutional coordination that plagued the EBA during previous stress tests could resurface. With a complex web of agencies involved – stress scenario was designed by the European Systemic Risk Board, the ECB in its new role as the competent authority for the euro area, and the EBA in coordination mode – there is a risk of hiccups in sequencing and communication.

• One of the reasons the EBA was unable to ensure credible stress tests last time was because each stress test was conducted independently by national regulators, with no data verification from the EBA.

• In this year's tests, the actual stress tests will be conducted by the banks themselves, prior to the completion of the AQR process. The AQR outcomes will then be used to make adjustments to the stress tests. The sequencing of the asset quality review and the stress tests will therefore be critical.

• With such a complex task, involving multiple agencies with different tasks and timescales for completion, the EBA will face a coordination challenge in communicating the results. They will be keen to avoid provoking adverse market reactions over any failures and recapitalisation plans.

This Comprehensive Assessment is another step in a tougher and more harmonised European banking supervision. Although well organised, the rules are written and adjusted while the exercise is performed. The outcome is still difficult to predict as it appears that the AQR is going to lead to CET1 adjustments which were not initially expected. So the Stress Test results may be well worse than initially thought.

Although no one think that a Comprehensive Assessment of this amplitude will be a regular exercise, it is clear that the banks will need to adapt to be able to answer to the increasing demand of data and information to ensure a fair and homogeneous supervision. A clear message from the EBA is that banks should improve their IT solution to face this demand. The trend is not decrease the volume of information required. In addition, it is clear that both the markets and the regulators are in need of more assurance with regards to the quality of the bank's assets: AQRs has become a new tools which is going to be used widely across Europe.

ASSESSING THE BALANCE SHEETS OF EUROZONE BANKS

FOUR QUESTIONS TO EMMANUEL DOOSEMAN, PARTNER IN MAZARS GLOBAL BANKING PRACTICE.

BANK NEWS: Assessing the balance sheets of eurozone banks : the biggest and most comprehensive bank audit ever undertaken in the world by a regulator?

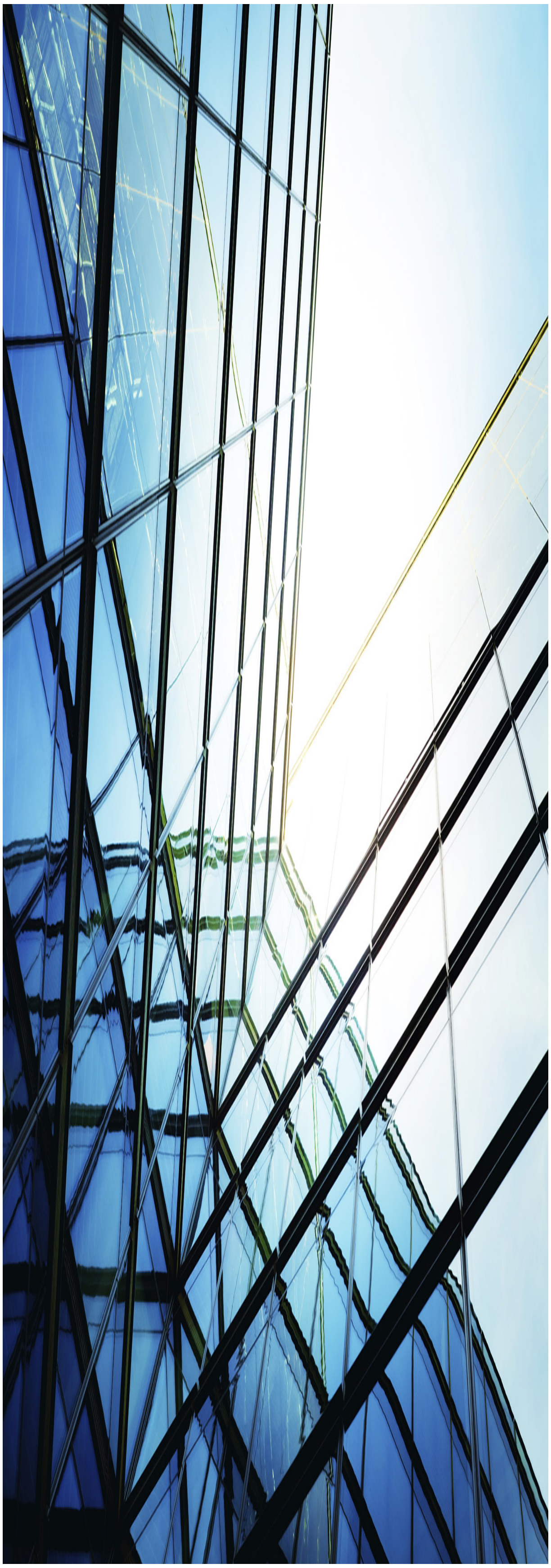
EMMANUEL DOOSEMAN : On October 21, 2013, the EBA published its recommendations on the way in which the banking supervisory authorities should conduct Asset Quality Reviews (AQRs). Two days later, the ECB provided details on how it intends to perform the assessment of the balance sheets of banks in the Euro zone, before taking over the direct supervision of significant institutions.

These 2 elements are the building blocks of a "due diligence" exercise hitherto unheard of, due to its scope and its depth of analysis, which is going to require a major mobilisation of risk, finance and IT functions and may require rethinking the organisations and systems.

BANK NEWS : Is the assessment of banks balance sheets by the ECB an unprecedented exercise?

EMMANUEL DOOSEMAN : By its magnitude, yes, as it focuses on 128 institutions whereas the exercise of the same kind performed in the United States in 2009 only concerned a few dozen banks. Furthermore, given the differences in economic models between the banks of the Euro zone which rely heavily on credit intermediation and the American banks, which have a more natural inclination towards disintermediation, the balance sheet exposure submitted to the audit carried out by the ECB will be far greater...

In France, it is not only the 13 French institutions concerned which the supervisor will have to deal with, as these audits also concern the subsidiaries of the banks of the Euro zone subject to the exercise. Given the very extensive audit objectives of the ECB, it is a huge task. Indeed, the assessment of banks' balance sheets goes much further than the mere review of the quality of assets (AQR).



BANK NEWS : In practice, what operations are performed in the banks?

EMMANUEL DOOSEMAN: The future single supervisor has implemented successive phases. The starting point was the assessment of the risk profile intrinsic to each institution which was complemented by the verification of the accounting rules and procedures implemented, along with a series of controls to ensure data quality and integrity were applied (existence, relevance, exhaustiveness). After this process, a portfolio review has been performed on significant and representative samples in order to project controls outcomes on the entire institution's balance sheet.

In essence, the exercise is similar to due diligence on the specific segment of credit and market assets. This requests the communication between and the reconciliation of several information systems, because if the data is present, it is frequently stored in different centralisation and reporting systems. The IT, financial and risk departments have been standing at the ready since October, and this will continue until autumn 2014.

BANK NEWS : Outside the quantitative aspect, what are the difficulties of the exercise for the banks?

EMMANUEL DOOSEMAN : The tight schedule represents a real and major challenge. In addition, this work also collide with the period of the annual closing of accounts : 2013 annual accounts and 2014 half-year accounts, which generally takes up much of the time of the financial and risk departments, the same team who will be requested to collect, process and communicate the information for the single supervisor.

Mazars assists banks and regulators with AQR and stress test processes.
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INVESTORS EXPECTATIONS OF THE ASSET QUALITY REVIEW

By Jean-Baptiste BELLON
Trapeza Conseil

TRAPEZA
perspectives financières

Trapeza is an independent consultancy and research firm specialising in the banking sector. Trapeza's role is to advise and assist banking professionals and investors on performance measurement. The analysis draws on several tools used on the financial markets, and brings together accounting, financial and strategic data.

In November 3013 the ECB launched a review of the banks' balance sheets, the Asset Quality Review or AQR, affecting a significant proportion of the banking sector in the Eurozone. This assessment will examine 128 institutions which are regarded as systemically important*, covering the first three banks of each of the 18 Eurozone countries along with banks that are 'significant' in terms of their balance sheet size, with the lower threshold set at €27 billion. The ECB is therefore covering a very high proportion of the Eurozone's banking system, since these banks represent 85% of the banking assets in the zone, and risk-weighted assets worth €3.72 trillion, equivalent to 58% of total Eurozone risk-weighted assets. This review is part of a broader exercise which includes the organisation of stress tests, and the results will all be published in November 2014, at the point when the ECB will assume responsibility for supervising systemically important banks under the new Single Supervisory Mechanism or SSM. The simultaneous occurrence of these two events is no coincidence. The ECB is conducting a thorough review before taking up its new role, even if cooperation with the national competent authorities (NCA) is crucial to the success of the exercise.

The primary aim of these investigations is to identify and then address any deficiencies in the banking sector so that it can act without inertia in the service of the economy when necessary. The economic recovery is still modest in Europe and the slight fall in loan volumes in the Eurozone does not seem to be due to restrictions on the supply of credit. But as the banks supply more than two-thirds of loans to businesses and households it is essential for the future of the economy in the zone that this question be addressed this year, 2014 being regarded as a transitional period.

The interests of the banks' managements do not necessarily coincide with those of the supervisory authorities, which represent the general interest. The performance of banks is based on an accounting system which has led today to a lapse of time between the recognition of revenues from loans (the income is booked as accounting revenue pro rata temporis from the time the loan is granted) and credit losses (the expenses associated with credit risk provisions are recorded once only, when there is objective evidence of impairment or loss). Prudence in the recognition of profits was a widespread quality in the banking industry, but the extent of this is potentially variable from one country or bank to another. The options which exist in the accounting principles in particular in terms of the timing of the recognition of the objective evidence of impairment, and supervisory practices, appear to have been used in distinct ways across Europe. .

* The figure of 128 banks includes four banks which are subsidiaries of the banks under review, and which are among the three largest establishments in the country (three in Slovakia and one in Malta).

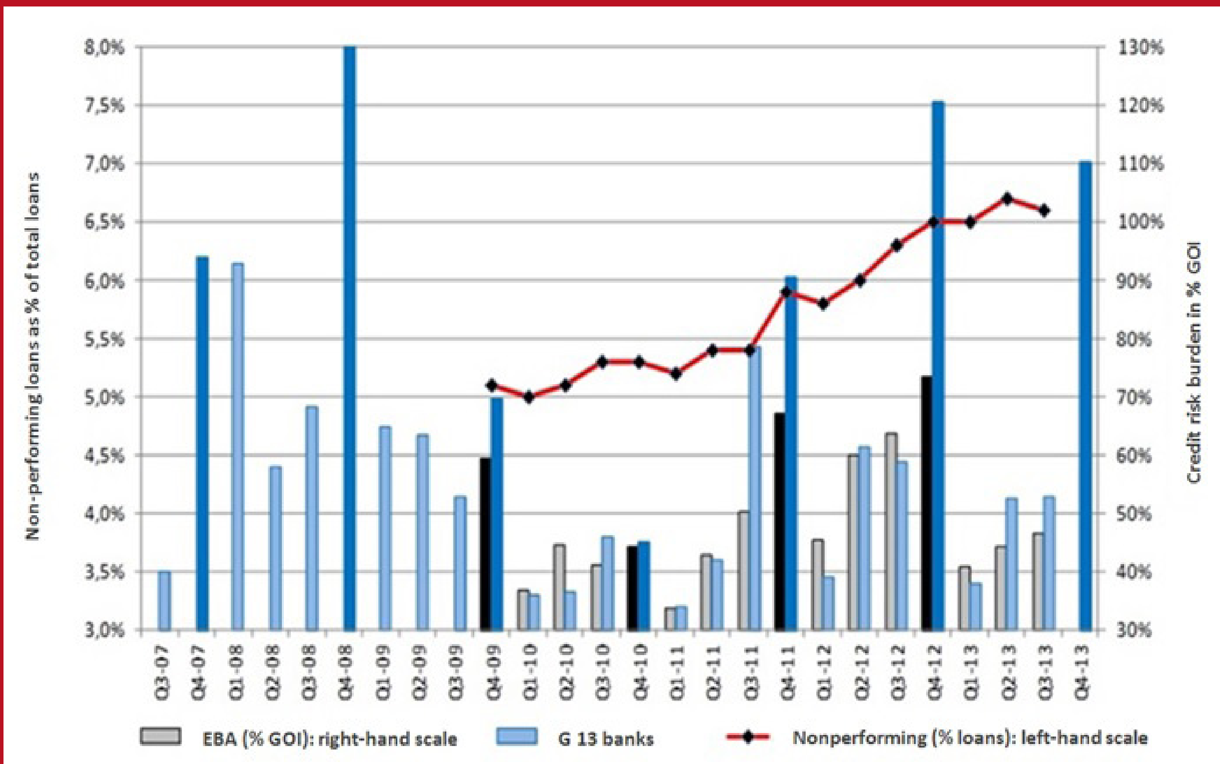
Because of this time lag between the recognition of credit income and expense, shareholders could suffer from information asymmetries. Managers may encounter problems and conceal them, only gradually revealing them as their cash flows are reconstituted, something which they can do all the more easily since crisis periods are frequently followed by a steepening interest rate curve which encourages an increase in cash flows even in the absence of additional credit risk.

This approach is used to deal with certain problems over time, but it also destroys shareholders' capacity to provide capital since they are unaware of the bank's situation, insofar as this can be known*.

* This point is in fact more complex, since it is not certain that managers, regulators and investors have access to the 'reality' of the situation; market valuations rely on conventions generally accepted on the markets and which can rapidly be called into question.

The AQR thus aims to provide investors (the market) consistent information on the risks run by the various European banks to enable them to allocate their resources optimally, with a capital cost that is adapted to each situation. This information is key when the banking context is characterised by increasing risk. After the sharp rise in the burden of risk at the start of the crisis, which absorbed more than three-quarters of cash flows between the end of 2007 and the end of 2009 with a peak in Q4-2008 (3x GOI), the risks fell again in early 2010 to 35%-40% of cash flow. But since mid-2011 the level of nonperforming loans (a lagging indicator) and the impact of losses and provisions in the GOI (a coincident indicator) have been rising fairly steadily.

RISK BURDEN AS % OF GOI AND WEIGHT OF NONPERFORMING LOANS.



Source : EBA Risk Dashboard Analysis and Trapeza analysis of results of 13 European banks.

This review is the more necessary to establishing the credibility of the ECB given that the other banking authority in Europe, the European Banking Authority, had failed to gain the confidence of investors during stress testing, most strikingly in 2011 before the sovereign debt crisis.

STRESS TEST HISTORY

Stress tests	no of banks	macro scenario (a)	capital threshold	test failures	capital requirement
Europe					
CEBS 2009 (b)	22	-3.8%	T1 de 4%	no	no
CEBS 2010	91	-3.1%	T1 of 6% (c)	7 banks	3.5bn€
EBA 2011	90	-4.1%	CE T1 of 5% (e)	8 banks	26.8bn€ (d)
EBA 2012 (f)	71	no	CE T1 of 9% (g)	27 banks	76bn€
BoE 2013 (b)	8		CE T1 of 7% leverage of 3%	5 banks	27.1bn£ (h)
EBA 2014	124	-5.6% (j)	CE T1 of 5.5%		
United States					
FED 2009	19	-3.8%	T1 of 4%	10 banks	185bn$
FED 2013	18	-4.3%	CE T1 of 5%	2 banks	
FED 2014	26	-3.3%	CE T1 of 5% (i)	3 banks	

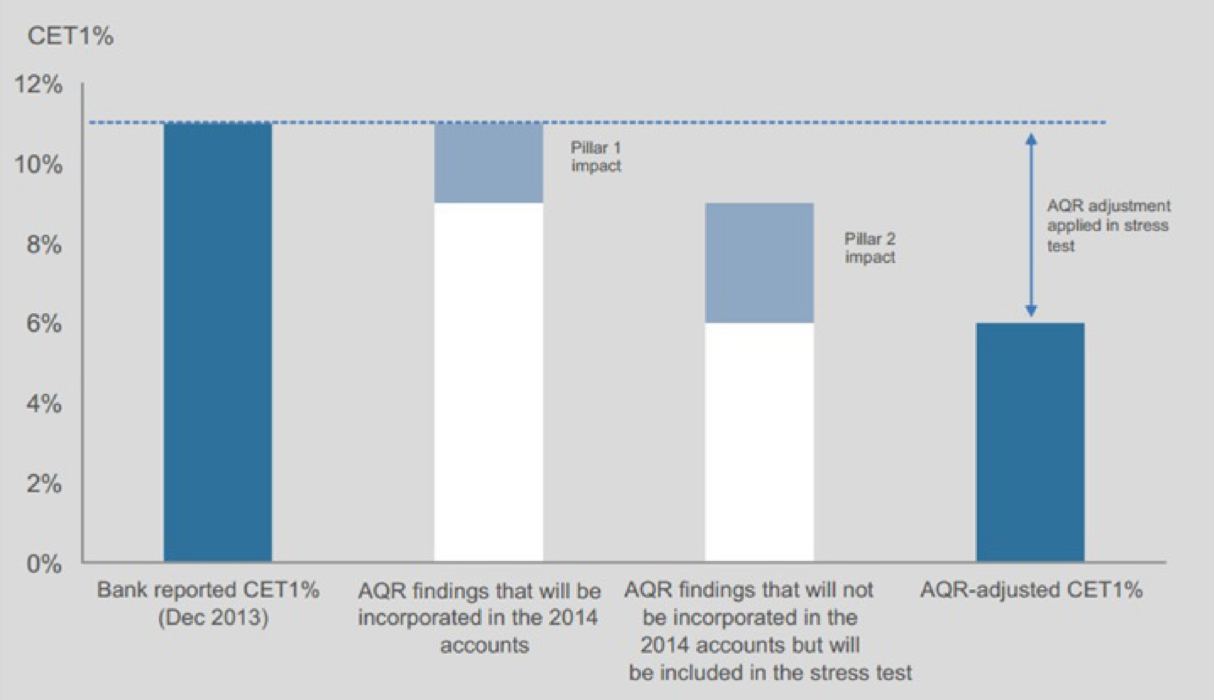
(a) Reduction in GDP over the period compared with central scenario
(b) Details of tests per bank are not published in their entirety
(c) Including operating risks
(d) Figure reduced to €2.5 billion after capital increases in the first 4 months of 2011
(e) Publication of information on sovereign risks and rise in finance costs
(f) Publication by country of capital requirements, excluding €30 billion for Greek banks
(g) Capital ratio required by June 2012 as a 'starting point'
(h) Figure reduced to £13.7 billion following measures taken by the banks
(i) Thresholds also include leverage ratios
(j) And -7% over the periods 2014-2016

Although the EBA did not convince as a supervisor, in 2013 it launched a measure better received by investors, on this occasion acting as a standard-setter, in particular for the definition of nonperforming and restructured loans*. The ECB's current asset quality review rests on this common definition. In March 2014 the ECB published an AQR manual which will be applied during the balance sheet review. Furthermore the ECB has indicated that there will be no reconsideration of the calculation of risk-weighted assets at the end of this exercise, with the exception of some details on the impact of guarantees and securitisations.

However, the capital ratios calculated by the ECB will be subjected to two types of adjustment to determine whether the bank genuinely has a ratio above the 8% minimum (which will serve as a starting point to verify whether the post-stress test level is above the 5.5% threshold). On the one hand there will be all the Pillar 1 adjustments to take account of incurred losses which the banks are obliged to include in the accounts from 2014. But there will also be Pillar 2 adjustments related to expected losses which the banks will be free to apply or not on an ongoing basis but which will have an impact on stress test outcomes.

* See, for example, the EBA's paper at: https://www.eba.europa.eu/regulation-and-policy/supervisory-reporting/draft-implementing-technical-standard-on-supervisory-reporting-forbearance-and-non-performing-exposures-

ILLUSTRATION OF AQR-ADJUSTED CET 1% APPROACH



Source : ECB - AQR manual

In the first category, the ECB expects that there will be accounting reclassifications (assets recognised at historic cost reclassified at fair value), basic corrections of factual elements relating to collective provisioning and to the valuation of the least liquid fair value assets (level 3) and adjustments for the counterparty risk of derivatives (CVA). The second category would include minor corrections to 'expectations' in terms of collective provisioning, re-estimates of the value of illiquid assets (insufficiently conservative estimates) and extrapolations of provisioning needs to all portfolios on the basis of the data gathered from the sample portfolios.

This gives the ECB very considerable power to impose common views beyond the choices of banks and their national supervisory bodies (NCA).

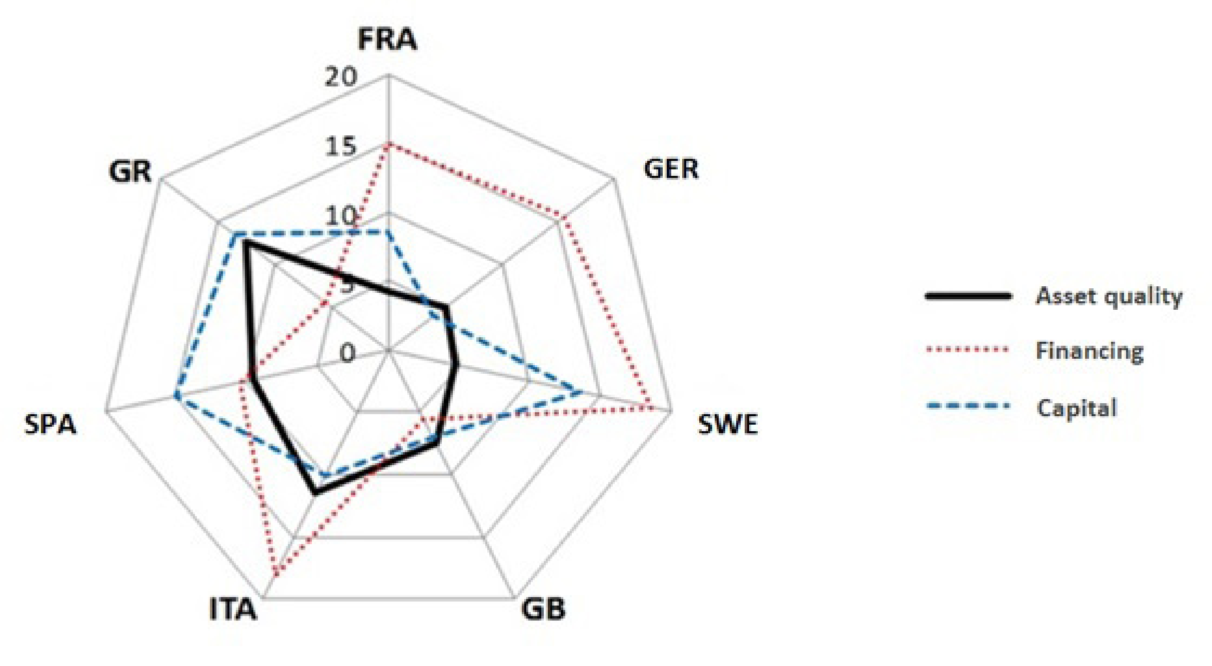
While officially no one has admitted to fearing the AQR, since 2013 the banks have begun to prepare for the ECB's oversight activities, and it is noteworthy that there have been:

- reclassifications of loans as nonperforming (especially in Spain),
- more than €10 billion capital increases announced or carried out (mainly in Italy, but also in Spain and Austria),
- and nearly of €25 billion in disposals of assets and loan portfolios (again in Italy and in Spain, but this has also been seen in Germany via the Commerzbank, for example).

If countries on the periphery of Europe are the subject of attention from investors, this seems to be part of a gamble on the occurrence of the 'final' stage of restructuring. As has been shown by the recent results announcements from major Italian banks*, investors give visible weight to a major balance sheet clean-up rather than the constitution of excess capital. The EBA's analysis by country (available for countries where more than three banks are monitored) in practice suggests a somewhat strained situation in the peripheral countries and a fairly favourable position for the major French and German banks.

* Thus in March 2014 Unicredit published a loss of €14 billion for Q4-2013, largely due to the constitution of €9 billion in provisions. The CET1 ratio was therefore lower than generally anticipated, but the share price rose by 7% on this announcement.

CLASSIFICATION OF COUNTRIES (MAJOR BANKS) BY THE EBA'S KPIs.



Source : EBA Risk Dashboard Analysis.

Against a background of moderate recovery in Europe, the AQR is regarded as more important than stress testing by investors, because recession scenarios are less appropriate to this phase of the cycle.

The AQR will be a success if the banks continue to value themselves at more than their net tangible assets, which would allow them to present their business plans more confidently to the market, the ECB in its supervisory role leaving it to investors to make their capital allocation choices thanks to renewed faith in the quality of information.

ASSET QUALITY REVIEW : INTERVIEW

HERVÉ ALEXANDRE

PROFESSOR AND HEAD OF THE BANKING AND FINANCE PROGRAM AT PARIS-DAUPHINE UNIVERSITY

BANK NEWS : Do we need this Asset Quality Review?

HERVÉ ALEXANDRE: Yes, and for more than one reason.
A good deal of liquidity has been injected into the European banking system but this has largely happened in a relatively opaque fashion. For example, it's interesting to see that no information has been made public about the individual calls of banking establishments during the successive waves of the LTRO (Long Term Refinancing Operation). But this would have brought some helpful additional insights to the financial disclosures on liquidity made by these same banks.

Despite the changes introduced by the requirements of the Financial Stability Forum or accounting and prudential regulators regarding the quality and quantity of disclosures published by the banks, there remains a widespread impression that information is to some extent intentionally obscured. This is sometimes due to the complexity of the language or the instruments used, but these too are contrivances that some seem to use to restrict the universal accessibility and comprehension of the information.

This exercise ought to deliver a clearer external vision of the situation of the banks, removing some of the vagueness that surrounds this subject.

This attempt at clarification, at clarity, ought to lead to increased confidence in the banking system, and that's absolutely crucial. An ailing or convalescent banking system is a major risk to the economy and growth. Japan offers a stark example of the impact that a badly-handled banking crisis can have on the economy.

BANK NEWS: What are your expectations of the AQR conducted by the ECB in the Eurozone?

HERVÉ ALEXANDRE: As I've already said, I'm hoping to see some clarification of the current situation of the banks in the Eurozone, but I also expect greater comparability and some perspective.

People expect to know what's in the balance sheet, but they also want to be able to understand and compare them better. The information available is currently not always helpful for making comparisons or putting things into a geographical or historical perspective. The underlying assumptions are not all provided in such a way that external third parties can reassess cohort and compare them across Europe.

So the introduction of a single Europe-wide definition of Non-Performing Exposure (NPE) represents a significant advance which could improve comparability between banks. Conversely, this definition - which was only reached at the end of 2013, and which will be used in the AQR and stress tests - enables us to demonstrate the divergent nature of the information provided by European banks up till now.

I also hope that various other simple indicators of liquidity or solvency can be communicated in the interests of comparability and demystification. Obviously these indicators must not be simplistic, but too much complexity is equally dangerous to confidence.

BANK NEWS: Do you think the review will bring some surprises?

HERVÉ ALEXANDRE: The subject that has been more or less overlooked up till now, but which the AQR might perhaps raise, is the real condition of the German Landesbanks. They have relatively high risk exposure profiles. Nevertheless, they have had the advantage and the benefit of flourishing local economic circumstances and favourable accounting rules which have enabled some of them to avoid having to measure their assets at fair value.

It is interesting to observe that it has already had an impact, in essence. At the end of the 2013 financial year some banks, in some countries, seem to have carried out an extensive clean-up exercise, even though the situation seemed to be improving throughout 2013. In one way this is reassuring because it means that an in-depth review has been carried out. But on the other hand it's worrying, because we have had to wait for a supra-national review before this was done and the lessons learned.

More generally, I also share the view of Danièle Nouy that some banks will fail during the exercise, and that this may be salutary.

BANK NEWS: Isn't the review too vast?

HERVÉ ALEXANDRE: Yes, it's a very large-scale review, perhaps too large. But in reality it's quite difficult to imagine what that represents in terms of the volume of work, human resources, documentation to read and review. Maybe there are some shortcuts that could be taken to meet the timetable. Perhaps at a certain point formalism will triumph over substance, the rule over the principle, to achieve the quantitative targets set. But if the areas most at risk are properly inspected (level 3 assets and NPEs in particular) we might nevertheless conclude that, for once, they've been as good as their word.

BANK NEWS: What will be the impact of this review on banking supervision in general?

HERVÉ ALEXANDRE: The AQR is the fundamental

element for establishing the ECB and the Banking Union in its supervisory pillar. It must make it possible to lay the foundations for the ECB's future oversight practice, to draw lessons on how the national authorities have acted up till now, and to avoid as far as possible falling into some of the traps that may be identified.
This will certainly mean setting a clear course between two approaches to regulation and supervision which coexist in Europe, the one founded on rules and the other on principles.

BANK NEWS: What is your perspective on the stress tests conducted in the US and the AQR and European stress tests?

HERVÉ ALEXANDRE: The finger has been pointed at Citigroup and in a way that has given the exercise credibility. That calls into question the idea that you can be 'too big to fail' and the leniency that you might think the major players receive because of their size and their systemic risk. The United States have said that the big players weren't protected, that they weren't immune.

The AQR and the European stress tests must be able to give the financial and economic community this same impression. Taking that to the extreme, I'd even say that it needs to be able to test the European Stability Mechanism to some extent, and to test the actual capacity of states in the Eurozone to implement this mechanism.

I don't believe that if everyone needs to recapitalise at the same time in November it will be possible, it will certainly be necessary for the banks to move closer to each other.

FINANCE EDUCATION : THE PARIS-DAUPHINE UNIVERSITY AND MAZARS

Mazars is a global partner of the Paris Dauphine University and its Dauphine Foundation. The aim of the Foundation is to develop the university's strategic and innovative projects: raising the profile of its research through teaching and research chairs, fostering the entrepreneurial spirit via its incubator, promoting equal opportunities, broadening its international scope and encouraging innovative education.

Mazars is involved educationally through experienced auditors who regularly take part as teachers on a range of Masters courses. For example, Emmanuel Dooseman, Partner, and Zied Loukil, Senior Manager in the banking sector give courses on IFRSs and their application in the banking industry to Finance and Banking Masters students.

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Nº1
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