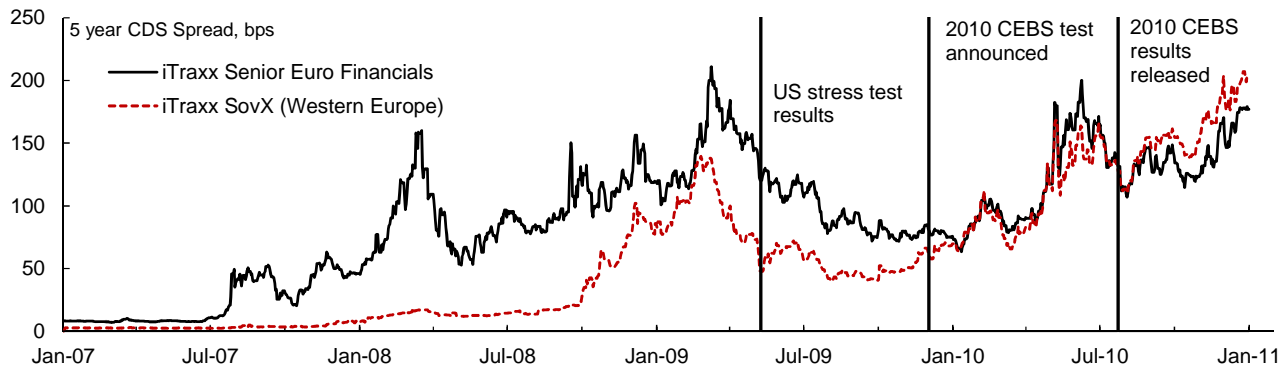


2010 EU-Wide CEBS Stress Tests

Background: interconnection between a weak banking sector and over-indebted governments

- Obvious to the market that the fate of banks and sovereigns were closely linked
→ protection on European banks and sovereigns moved in lockstep beginning in Q1 2010 (see figure below)
- But there was little transparency in banks' exposures, so investors assumed the worst for all banks and raised funding costs for everybody

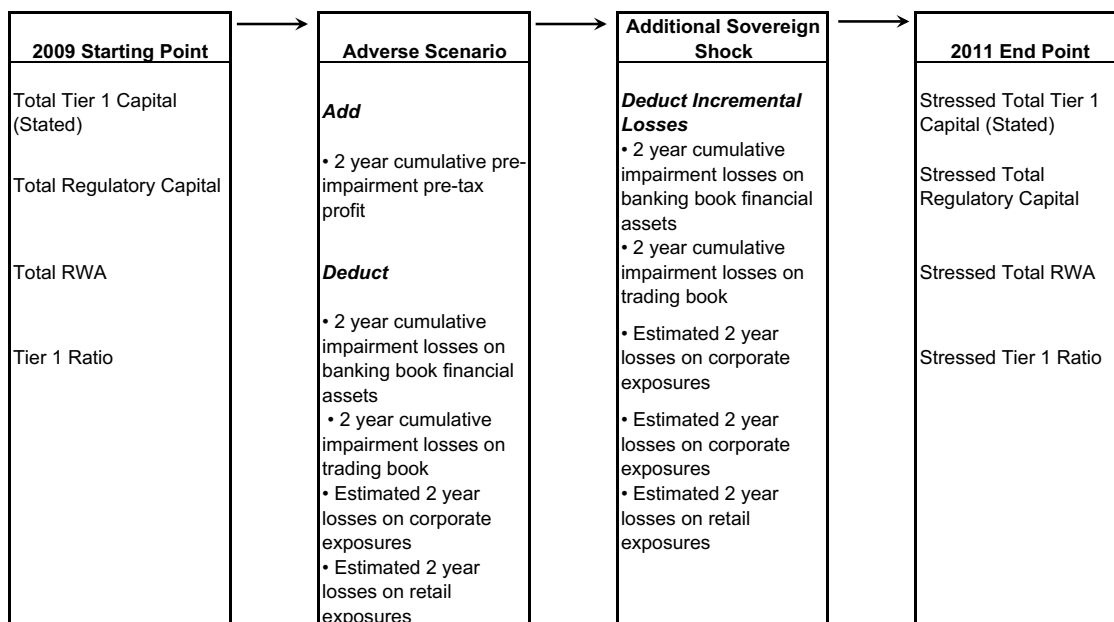


The test aimed to assess “banks’ ability to absorb further credit and market shocks...and their dependence on public support measures”; but the real value was in the clarity and transparency provided by the test (not unlike the 2009 SCAP)

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Test Design in a Nutshell

Hurdle rate: 6% Tier 1 Capital



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Results

- ▶ Released July 2010.
- ▶ Total capital needs of all failed banks: €3.5 billion.
- ▶ 7 banks failed; 2 of which already nationalized (only 1 Greek bank failed).
- ▶ Interbank funding didn't ease; cost of protection remained high.
- ▶ SCAP-like: results were published in great detail (and the methodology was more transparent than SCAP).
- ▶ Included sovereign support announced before July 2010.
- ▶ 20 banks benefited from asset guarantees.
- ▶ 34 benefited from €170 bn of aggregate public capital, about 14% of aggregate Tier 1 capital (ultimately increasing stressed Tier 1 capital by 1.2%).

Key Design Decisions & Credibility

1. Inclusion of sovereign support.
2. Sovereign debt haircuts were applied to trading books but not banking books.
3. Forecast assumptions provided by national supervisors varied dramatically: for example, commercial real estate prices were modeled to decline 55% in Spain compared to 7% in Greece.
4. CEBS, 27 national supervisors, the EU Commission, and the ECB worked together on the test.
5. Supervisors published the methodology of the stress test and its results at a very detailed level.
6. Low hurdle rate – many expected 6% core Tier 1.