SPECTRUM
Asset Management

Euro Bank Stress Test

Positive Results. Supportive of AT1s

July 31, 2023

The bank stress test results released on July 28, 2023 by the European Central Bank (ECB) and European Banking Authority (EBA) show that "the euro area banking sector is overall resilient to a severe economic downturn, as represented in the adverse scenario." This stress test covered 98 banks (57 large banks and 41 medium-sized banks) and showed that "three years of severe economic stress would cut [the] CET1 ratio of ECB-supervised banks by 4.8 percentage points to 10.4%." The regulators further note that "improved asset quality and profitability helped banks stay resilient amidst highly adverse conditions." The 98 banks tested represent around 80% of the euro area's banking assets.

The large banks tested started with an average fully-loaded CET1 ratio of 15%. Under the adverse scenario, capital dropped 4.59% to 10.4%. Under the baseline scenario, the CET1 capital ratio increases 1.36% to 16.3%. The regulators note that "despite combined losses of EUR 496bn [under the adverse scenario], EU banks remain sufficiently capitalised to continue to support the economy." *Only nine* of the 98 banks tested would have difficulty meeting their legally binding total SREP (Supervisory Review and Examination Process) capital requirements and/or leverage ratio requirements. Given the diversity of banks and member states in the EU, this is not surprising.

The regulators note that the stress test is not a pass/fail exercise resulting in prompt requirements for recapitalization, but rather informs the regulatory process for each institution. Spectrum is encouraged that "the banks' capacity to generate income has been boosted by the expansion of lending margins combined with slower adjustments of deposit rates, amid rising interest rates in the past year. These developments have allowed banks to better withstand the high severity of the adverse scenario compared to the 2021 stress test." We also note that the stress levels in the 2023 test were more severe than in the 2021 test.

Over 90% of the banks tested did not have difficulty meeting their SREP capital requirements, but some fell a bit short. While this is not surprising given the wide range of banks tested, it also highlights the importance of individual bank selection. On the whole, when examining these results, along with similar recent stress tests results from the US Federal Reserve (LINK) and Bank of England (LINK), Spectrum continues to be encouraged by the strength and resiliency of major market banks. We further believe they have the capacity to survive highly challenging economic circumstances as well as continue to play vital roles in the economy and to honor their preferred stock and AT1 security obligations.

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