EU stress tests

Aberdeen

For more information

None of the seven banks that failed the EU's stress tests are held in our equity portfolios. In terms of our fixed income portfolios, we have minimal exposure to the seven banks.

Overview

In the end, the much anticipated results of the EU's bank stress test exercise were not as revelatory as billed. The aim was to assess the resilience of the EU banking system to another economic downturn and the ability of banks to absorb adverse movements in sovereign debt and credit markets. However, political necessity meant we were never going to see a huge number of banks fail.

Of the 91 banks surveyed, seven would see their Tier 1 capital ratios fall below the 6% benchmark (4% is the regulatory minimum) following a severe sovereign shock. The unfortunate seven contained no surprises – five Spanish regional savings banks, Germany's Hypo Real Estate and Greece's ATEbank.

In addition to the seven banks that failed, those that just passed – Italy's Monte del Paschi (6.2%), Allied Irish Banks (6.5%) and Germany's Postbank (6.6%) will come under pressure to obtain additional funding. Already Civica, one of the five Spanish banks that failed, has secured €450 million of convertible bond finance from JC Flowers, a private equity house.

Arguably more banks would have failed had the Committee of European Banking Supervisors (CEBS) adopted more strenuous modelling. Rather than a 3% deviation in the EU's growth forecast they could have factored in a greater than 5% double-dip. Furthermore the CEBS assumed no sovereign default, with the worst case scenario a 23.1% haircut on Greek sovereign debt. This assumption is understandable to a degree given that European politicians have made it clear there will be no European government default. However, for this to be the case Greece will require huge financial support from the likes of Germany.

While the stress tests were perhaps too soft, they have provided a line in the sand. The European banking system appears reasonably well placed to withstand a conventional downturn. However, the results tell us little about how banks would cope in more extreme scenarios. Consequently we continue to believe that greater disclosure by banks of the nature of their asset bases and liquidity profiled will be crucial components of furthering fostering confidence in the banking system and for allowing investors to make their own regular "stress tests" of the companies they wish to consider allocating capital to.

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