

Austrian Banks in the Comprehensive Assessment

Maximilian Fandl,
Robert Ferstl¹

2014 was a historical year for banking supervision in the euro area and in Austria. After an assessment of the European banking system of an unprecedented scale known as the comprehensive assessment, the Single Supervisory Mechanism (SSM) entered into force in November, with the ECB taking over supervisory responsibility for 120 significant institutions, including 8 Austrian banks.² This short article gives an overview of the results of the comprehensive assessment (CA) of the participating Austrian banks and compares them to those of other European banks.

The comprehensive assessment consisted of an asset quality review (AQR) and a stress test. The AQR was based on banks' end-2013 balance sheets and took an in-depth look at their loan books, including an assessment at the individual credit file level. The stress test, as the second component of the exercise, was forward-looking and assessed the banks' ability to withstand hypothetical adverse conditions in the years 2014 to 2016. To reach a consistent view, the AQR findings were integrated into the stress test and thus made the final results more conservative than those of previous European stress tests. The exercise was truly European in the sense that it was based on common scenarios and methodologies for all banks combined with

an in-depth quality assurance process under the aegis of the ECB for all 130 participating banks in 19 countries.³ This process was strongly supported by the national central banks and supervisory authorities.

The results of the comprehensive assessment were published on October 26, 2014. The widely reported headline result was an aggregate capital shortfall of EUR 24.6 billion across 25 banks, including one Austrian bank (Volksbanken Verbund) with a capital shortfall of EUR 865 million. After deducting capital measures taken during 2014, the net capital shortfall that remained at the euro area level was EUR 9.5 billion. The affected banks were requested to submit capital plans and take measures in order to cover the identified capital shortfalls within six to nine months.⁴ The capital plan submitted by Volksbanken Verbund is currently being assessed by the Joint Supervisory Team under the lead of the ECB as the new supervisory authority. Apart from Volksbanken Verbund, the other five Austrian banks passed the CA without capital shortfalls.⁵

Beyond the headline figures, the granular CA results provide a useful basis for comparisons between Austrian and other European banks. The waterfall charts 1 and 2 illustrate the main drivers of the

¹ Oesterreichische Nationalbank, Supervision Policy, Regulation and Strategy Division, Maximilian.Fandl@oenb.at and Robert.Ferstl@oenb.at

² The six Austrian banks in the assessment were BAWAG PSK, Erste Group Bank, Raiffeisen Zentralbank Österreich, Raiffeisenlandesbank Niederösterreich-Wien, Raiffeisenlandesbank Oberösterreich and Volksbanken Verbund. The two other Austrian SSM banks, Sberbank Europe and VTB Bank, were classified as significant institutions in September 2014 due to their cross-border activities but were not included in the comprehensive assessment sample. UniCredit Bank Austria was assessed as part of the Italian-based UniCredit group.

³ The euro area and Lithuania, which will join the euro area in 2015. The vast majority of the 130 participating banks in the CA were classified as significant credit institutions in September 2014 and have thus been under direct supervision of the ECB since November 2014.

⁴ Nine months if the capital shortfall arose under the adverse scenario.

⁵ The ECB and the EBA published the individual bank results of the CA on their websites.

AQR-adjusted results in the adverse scenario for Austrian banks compared to the euro area average.

The waterfall charts should be read from top to bottom. The first blue column indicates the starting common equity tier 1 (CET1) ratio at end-2013, followed by the AQR impact (orange column in percentage points) that adjusts the starting point for the stress test downward (second blue column). The subsequent red and green columns illustrate the main drivers of the stress test. The most important ones are operating income excluding the cost-of-funding and market risk shock (*OpInc excl. CoF, MR*), the cost-of-funding shock (*Delta NII*) and credit risk costs (*CR costs*). The third blue column (*CET1R YE16 (phase-in)*) shows the CET1 ratio in the adverse scenario at end-2016 (post-AQR and join-up effects). This column represents the final CA stress test result that is used to determine capital shortfalls in the adverse scenario if the ratio of the individual bank falls below 5.5%. The final adverse CET1 ratio is different from the so-called “fully loaded” Basel III CET1 ratio. While the former only includes Basel III phase-in effects (i.e. changes in the CET1 capital definition) from 2014 to 2016 (*B3 phase-in (<=2016)*), the latter also incorporates Basel III phase-in effects after 2016 (*B3 phase-in (>2016)*). The adverse fully loaded Basel III CET1 ratio is disclosed as a memorandum item in the last column of charts 1 and 2.⁶

This relative analysis yields the following main observations:

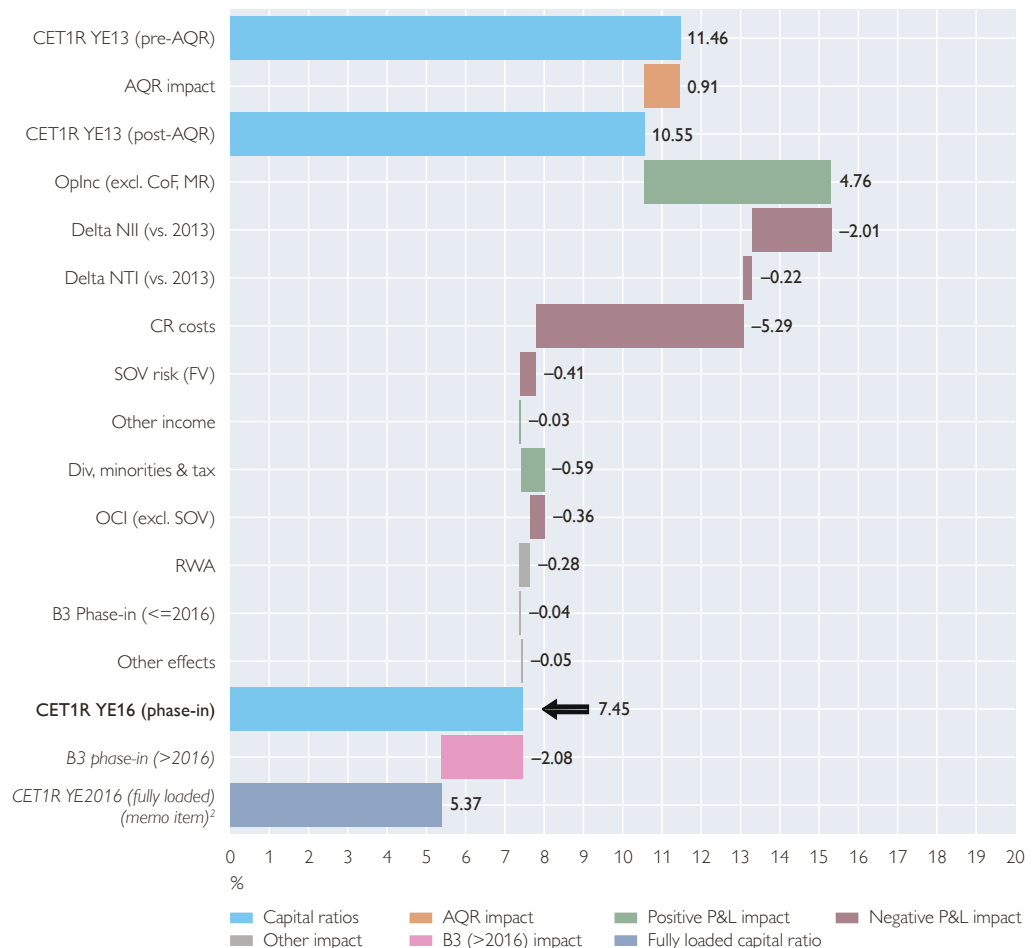
- The starting CET1 ratio of the Austrian banks stood slightly below the

euro area average, driven by the below-average CET1 ratios of the two large Austrian banks.

- The AQR impact was more than twice as high for Austrian banks (91 basis points) than for the euro area average (41 basis points), mainly driven by CESEE portfolios with elevated risk profiles, in particular in Hungary and Romania. This observation is in line with the euro area-wide result that AQR findings tended to be higher in countries with on average riskier portfolios (e.g. in the euro area periphery or in CESEE). For the overall exercise it should be noted, however, that the total impact was driven by the stress test rather than by the AQR.
- The development of the profit and loss components in the stress test results for the Austrian banks is broadly comparable to the euro area average (see charts 1 and 2). Austrian banks were on average more affected by the cost-of-funding shock, credit risk costs and Basel III phase-in effects after 2016 than the euro area average. As mentioned above, the latter are included as information items and are not considered in the determination of the capital shortfall.
- Austrian banks also show higher operating profits than the euro area average, which mainly reflect their significant CESEE operations. Furthermore, Austrian banks are less affected by the increase in risk-weighted assets (RWAs) than the euro area average, which is partly due to less reliance on internal ratings in their RWA determination.

⁶ The reported Basel III phase-in effects for Austria still include the participation capital of BAWAG PSK and Raiffeisen Zentralbank Österreich that was repaid in the first half of 2014. Participation capital is not eligible as CET1 capital under the fully loaded Basel III definition.

Comprehensive Assessment – Austrian Banks in the Adverse Scenario¹



Source: ECB, EBA, OeNB.

¹ All figures next to the bars are in percentage points of the CET1 ratio as of 2016 (adverse scenario).

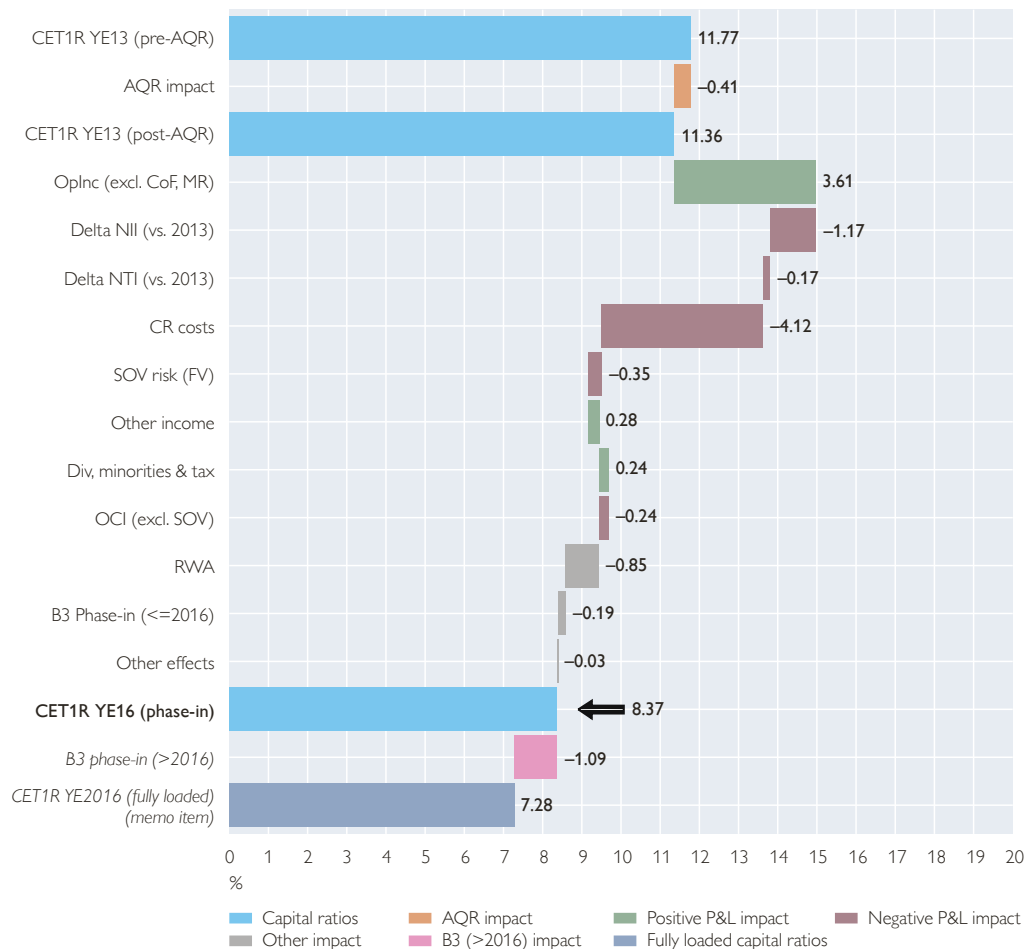
² Fully loaded Basel III CET1 ratio including capital measures taken from January to September 2014: 6.25%.

- Since the business profiles of the six participating Austrian banks are rather heterogeneous, it is also useful to analyze the main drivers at the individual bank level. In this comparison, the results of large Austrian banks with a CESEE focus were driven more by higher operating profits and credit risks costs, as were those of European peers with significant CESEE or other emerging market operations. Domestically focused Austrian banks were primarily affected

by weaker operating profits, mainly because they have lower net interest income and other income components but also partly because of idiosyncratic factors, such as the net trading income shock for BAWAG PSK. The only Austrian bank with a capital shortfall, Volksbanken Verbund, reported low results in all main drivers of the stress test and could not make much use of the exemption from the static balance sheet assumption, as it is significantly

Chart 2

Comprehensive Assessment – Euro Area Banks in the Adverse Scenario (Weighted Average of the 130 Participating Banks)¹



Source: ECB, EBA, OeNB.

¹ All figures next to the bars are in percentage points of the CET1 ratio as of 2016 (adverse scenario).

ahead of its European Commission-approved restructuring plan.⁷

It is important to note that the CA results are based on end-2013 balance sheets and do not take capital measures in 2014 into account. In interpreting the CA results, the capital measures and other developments during 2014 must thus be considered as well. In the case of the Aus-

trian banks, this aspect is particularly relevant with respect to the capital increases and repayment of participation capital by two Austrian banks in the first half of 2014, which impact the results based on the fully loaded Basel III capital definition.⁸ Moreover, the interpretation of results must also take into account the methodology and

⁷ Under the static balance sheet assumption, the components of the banks' balance sheets do not grow or decline during the stress horizon and the business mix remains unchanged. For banks under restructuring, such as Volksbanken Verbund, an exemption from the balance sheet assumption applies. These banks consider the European Commission-approved restructuring plans in the projection of balance sheets components.

⁸ BAWAG PSK and Raiffeisen Zentralbank Österreich.

the scenarios. The recent changes in the macroeconomic outlook for the euro area are not incorporated, even though current growth forecasts are still considerably above the paths in the adverse scenario. Moreover, only intra-EU exchange rate fluctuations are included in the stress test. Ukraine and Russia are subject to severe macroeconomic stress in the adverse scenario, but an outright escalation of political tensions in Ukraine is not taken into account. Lastly, as with any stress testing exercise, limits of scope have to be considered.

The OeNB actively supported the CA as an important step in promoting the transparency of banks' balance sheets and in

fostering confidence in euro area banks. While the results show the improved resilience of Austrian banks under the simulated conditions of the adverse scenario, the results also indicate the need for most Austrian banks to further strengthen their earnings potential and capital positions, in particular with a view to the transition to Basel III. In this respect, the results of the CA support the OeNB's ongoing analysis and long-standing policy stance – as reported in recent OeNB Financial Stability Reports – that Austrian banks need to take further action to continue increasing their CET1 ratios in the next few years.