July 23, 2010

PRESS RELEASE

Results of the EU-wide stress test
“French banks among the strongest in Europe”

The Committee of European Banking Supervisors (CEBS), in conjunction with national supervisory authorities, has just completed a stress test exercise designed to assess the financial strength of 91 banks in 20 countries of the European Union.

This exercise, of unprecedented size, provides a comprehensive snapshot of the condition of European banks. The 91 banks participating in the study account for nearly two thirds of the total assets of the EU banking system; the corresponding figure for the French banks participating in the study is close to 80 percent. This high rate of participation ensures the representativeness of the sample.

The stress scenarios used in the exercise were developed in collaboration with the European Commission and the European Central Bank (ECB). The scenarios were harmonised at the European level and then adapted to the circumstances of each country, resulting in a unique scenario for each country (see *Annexes / Sheet 1: An exercise harmonised at the European level*). The benchmark scenario assumes a moderate stress relative to current forecasts, while a very adverse scenario was applied plus a specific shock to banks’ exposures to sovereign debt. (S*ee Appendices / Sheet 2: Scenarios*).

Four major French banking groups participated in the exercise: BNP Paribas, Société Générale, Groupe Crédit Agricole, and BPCE. All of these institutions passed the test. The results confirm the robustness of the French banks, which are among the strongest in Europe (see *Annexes / Sheet 3: The results for French banks*). This result was not unexpected, given the encouraging results obtained from stress tests regularly conducted in France and the recognised capacity of French banks to weather the recent financial crisis.

Principal findings of the EU-wide stress test: the French system of universal banking has once again demonstrated its resilience to a crisis. The results of the EU-wide stress test show that it retains its capacity to ensure the orderly financing of the economy under both benchmark and severely stressed scenarios (*see Annexes / Sheet 4: Conclusions for French banks*).

Stressing the “extremely ambitious nature of the exercise,” Christian Noyer, Governor of the *Banque de France* and Chairman of the *Autorité de Contrôle Prudentiel*, welcomed the favourable results, which show once again “the excellent capacity of the French banking system to withstand stress. French banks are currently among the most sound in Europe”.

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ANNEXES / SHEET 1

An exercise harmonised at the European level

The stress test provides a reliable and credible assessment of the capacity of the European banking system to withstand stress, thanks to the appropriateness, consistency, and homogeneity of the methods used:

1 The benchmark and stressed macroeconomic assumptions used by the CEBS and supervisors were established by the European Commission and the ECB. The macroeconomic framework of the exercise is both harmonised at the European level and adapted to the circumstances of each country (one scenario per country).

2 For the purposes of phase 1 of the exercise (measuring the impact of the macroeconomic stress):

   a. Stress on the banking book that is key in terms of its impact on the Tier 1 capital ratio, was measured using ECB estimates of the sensitivity of banks' risk parameters (PD and LGD) to macroeconomic conditions. This approach established a reference methodological framework at the European level.

   b. The methodologies for stressing securitisation positions and available-for-sale equity were established unilaterally and harmonised at the level of the CEBS Secretariat.

3 In phase 2, which measured the impact of a "sovereign shock", additional shocks to the banking book (focusing on private sector credit) and the trading book (focusing on central government bonds) were established using parameters provided by the ECB and the CEBS Secretariat at the European level.

4 The stress to trading activities other than sovereign stress (whose impact on Tier 1 capital is smaller than that of other types of stress, such as stress to credit activities) and to expected bank earnings has been defined by each bank. The General Secretariat of the ACP ensured the appropriateness of the estimations, and the CEBS Secretariat reviewed their consistency.

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<u>ANNEXES / SHEET 2</u>

Scenarios

1 The first scenario, referred to as the "benchmark macroeconomic scenario", corresponds to a moderate stress. It assumes 0.7% growth in 2010 and 1.5% growth in 2011 for the euro area as a whole, and 1.2% growth in 2010 and 1.5% growth in 2011 for France. It should be kept in mind that this is not a forecast; it is only a working assumption. To put these figures in context, the IMF forecasts 1.0% growth in 2010 and 1.3% growth in 2011 for the euro area, and 1.4% growth in 2010 and 1.6% growth in 2011 for France; while the OECD forecasts 1.2% growth in 2010 and 1.8% growth in 2011 for the euro area, and 1.7% growth in 2010 and 2.1% growth for 2011 in France.

2 The second scenario, referred to as the "adverse macroeconomic scenario", is more severe; it assumes an extremely recession with no immediate recovery. Under this working assumption of a 'double-dip' recession, growth would fall sharply. For example, GDP in the euro area would decline by 0.2% in 2010 and 0.6% in 2011, while GDP in France would increase by 0.7% in 2010 and decline by 0.1% in 2011.

<u>For France</u>, the adverse scenario represents to a cumulative loss of growth at the stress horizon of 2.1 percentage points, relative to the benchmark scenario. In light of the growth carried over, it implies negative growth over the rest of the year. The unemployment rate envisaged in the adverse scenario is close to the highest level recorded since 1975. Short-term interest rates would reach the levels reached during the 2007-2008 financial crisis, while long-term interest rates would approach the levels of the early 2000s. The downturn in the real estate cycle would be very severe, representing a sharp break from the improvement in the market experienced since 2009.

3 Because the markets have expressed concerns about the sovereign debt of certain countries in the euro area, the adverse scenario, which was already extremely pessimistic, was reinforced with the assumption of a severe shock to sovereign debt held in banks' trading books and to private-sector loans held in the banking book. The method used consisted of applying haircuts – ranging from 4.2% to 23.1%, depending on the country concerned – to banks' trading book exposures to the sovereign debt of each of the 30 countries in the European Economic Area, as well as additional losses on private sector exposures in the banking books of these countries.

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<u>ANNEXES / SHEET 3</u>

Results for French banks

Aggregate figures are given below for the four French banks that participated in the exercise: BNP Paribas, Groupe Crédit Agricole (including its *caisses régionales* and their subsidiaries, as well as its central body), Société Générale, and the BPCE Group (including its two cooperative networks and their subsidiaries, as well as its central body):

1 In the numerator of the Tier 1 ratio:

- The sum of the cost of risk in the banking book and the losses in the trading books under the adverse scenario, without considering the sovereign shock, came to EUR 61.3 billion (cumulative figure for 2010 and 2011). This compares with a total cost of risk of EUR 24.8 billion for the four banks for the single year of 2009. Thus the 2011 adverse scenario, even without counting the effects of the sovereign shock, represents an increase over the cost of risk in 2009: a year in which the crisis had already resulted in an increase of 57% in cost of risk over the preceding year. In addition to this figure, incorporating a sovereign shock, there are losses arising from the sovereign exposures in the trading book (EUR 3.7 billion) and additional provisioning for private sector exposures (also EUR 3.7 billion).

- These loss figures can be compared with gross operating income for the four French banks, which totalled EUR 83.1 billion under the adverse scenario (cumulative 2010-2011) and EUR 39.3 billion in 2009.

2 In the denominator of the Tier 1, the adverse scenario also results in significant deterioration in risk-weighted credit exposure. Under the adverse scenario, total risk-weighted assets of the four French banking groups are 11.4% higher at the end of 2011 than on December 31, 2009.

3 The adverse scenario results in an average Tier 1 ratio of 9.3% for the four institutions: well above the regulatory threshold, and also well above the 6% threshold used to judge the results of the test. This excellent result shows that French banks would suffer only a limited shock of 0.6 percentage point, which ranks them very favourably.

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Results of the EU-wide stress test

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ANNEXES / SHEET 4

Conclusions for French banks

The stress tests indicate that the French banking system is both recovering well (based on the results of the benchmark scenario) and resilient (based on the results of the adverse scenario). These conclusions are in line with the results of the national stress tests conducted at regular intervals in France. The principal characteristic of French banks is their excellent capacity to withstand stress: under the adverse scenario, their Tier 1 capital ratios are only 0.5 to 0.7 percentage points lower at the end of 2011 that at the initial point for the exercise, taken as December 31, 2009. And it should be noted that the French banks showed these strong results despite the fact that they no longer benefit from any form of public support, with the exception of one of these banks.

Among the factors explaining the resilience of French banks are:

1 The strength of income, even in a situation of severe stress, driven in large part by ‘interest’ income associated with their transformation business, prudent asset-liability management, and effective control of operating expenses.

2 The nature of their domestic real estate exposures, which appear to be soundly structured and have a low cost of risk.

3 Their resistance to the additional sovereign shock. The banks’ sovereign debt portfolios appear to be sufficiently well diversified to withstand the large shocks assumed by CEBS. The stress tests indicate that the shock to sovereign exposures would result in EUR 3.7 billion in incremental trading book losses for the four French banks, while the shock to the private sector would result in an additional 3.7 billion in provisions. Each of these shocks would reduce the Tier 1 capital ratio for the four institutions by an average of 8 basis points. Furthermore, the dispersion of this additional shock between banks is relatively low, between 9 and 22 basis points, confirming that none of these institutions is excessively exposed to sovereign risk.

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ANNEXES / SHEET 5

Macroeconomic scenarios for France and the Euro area

	France		Euro area	
Benchmark Scenario	2010	2011	2010	2011
GDP at constant prices - (y-o-y)	1.2	1.5	0.7	1.5
Unemployment (as % of the labour force at year-end)	10.2	10.0	10.7	10.9
Short-term interest rates (3M) at year end (Euribor or Libor depending on the country)	1.18	2.05	1.18	2.05
Long-term interest rates (10y) at year-end-Treasuries	3.81	4.11	3.50	3.80
Commercial property prices	0%	-3%		
Residential property prices	0%	-3%		
Adverse Scenario	2010	2011	2010	2011
GDP at constant prices - (y-o-y)	0.7	-0.1	-0.2	-0.6
Unemployment (as % of the labour force at year-end)	10.2	10.5	10.8	11.5
Short-term interest rates (3M) at year end (Euribor or Libor depending on the country)	2.10	3.30	2.10	3.30
Long-term interest rates (10y) at year-end-Treasuries	4.30	5.10	4.40	5.30
Commercial property prices	-5%	-5%		
Residential property prices	-5%	-5%		