

The European Stress Tests 2014

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Transparency, trust, and doubts

Does the Comprehensive Assessment enhance trust in banks?

Doubt 1

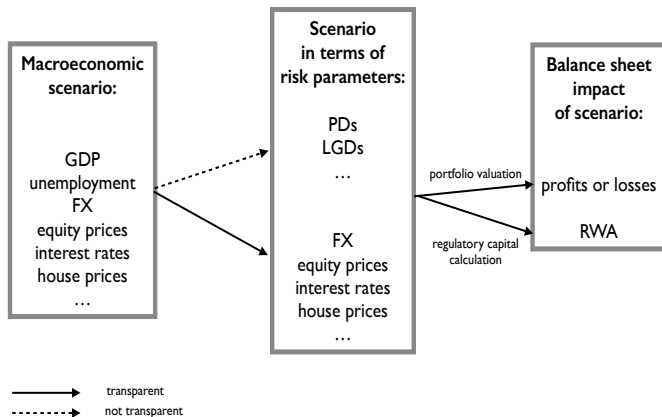
Restriction to one adverse scenario might foster an illusion of safety.

Danger: A bank faring well in one scenario is not necessarily safe in other scenarios.

Remedy: Consider several scenarios.

Heavy use of banks' internal models

threatens transparency and the level playing field.



Remedy: ECB publicly specifies risk parameters

Compulsory Recapitalisation after unsatisfactory stress test

—if impossible on the capital markets—
has to be shouldered by

- junior debt holders, leading to **second round effects of stress tests** if bank debt is held by banks, or by
- **taxpayers.**

Losses in stress scenarios have similar consequences as real losses.

Which systemic risks have been highlighted?

- ① Interaction of banks in the system is reflected by correlation of markets.
- ② Second round effects from banks holding equity or debt of other banks are neglected.
- ③ Second round effects triggered by reactions of banks are neglected (static balance sheet).