

News

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MOODY'S ANALYTICS: AQR AND STRESS TEST REQUIREMENTS TO POSE CHALLENGES FOR EUROPEAN BANKS

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LONDON, 14 August, 2013 — Moody's Analytics, a leader in risk measurement and management, has released two reports outlining the challenges associated with the upcoming Asset Quality Review (AQR) and subsequent stress test requirements for European financial institutions.

The Moody's Analytics report '[Asset Quality Review: Setting the Foundation for a Standard Stress Testing Framework](#)' looks at the main factors that are driving the AQR, discusses the need for a harmonized definition of non-performing loans that levels the reporting playfield across Europe, and analyses the move towards a bottom-up stress testing framework.

The European Central Bank (ECB) is expected to take over EU bank supervision next year and will conduct asset quality reviews and balance sheet assessments at the 140 largest banks, across the 17 EU countries. National banking supervisors will carry out asset quality reviews at major banks in the remaining 10 EU members. The results of the AQR are crucial, as they will be used in the next EU-wide stress test conducted by the European Banking Authority (EBA) and the ECB in the second quarter of 2014.

"We're expecting to see a bottom-up approach in the upcoming AQRs, similar to the ones performed in Greece, Spain, Cyprus, and Portugal in recent years. These exercises scrutinised the portfolios that faced the greatest credit deterioration during the crisis, such as corporate, commercial real estate, mortgages and consumer loans," states Alessio Balduini, Managing Director – Stress Testing and Asset Quality Review Coordinator (EMEA) at Moody's Analytics. "A major issue for the AQRs, which is currently being addressed by the EBA, resides in the definition of performing and non-performing loans, as there is currently no pan-European standard definition of the latter."

According to the Moody's Analytics report '[A New Generation of Stress Testing Processes for European Financial Institutions: Better Respond to the AQR and 2014 EU-wide Stress Test Exercises](#)' both the European authorities and financial institutions have started to take appropriate steps to address some of the challenges of moving toward more realistic stress testing frameworks, but further changes might be required.

"Assuming that the AQR and the EU-wide stress tests happen according to plan over the next 18 months, European banks may have to make some changes to the way they do business. They need to reassess their approach to loss modelling, enhance their coordination across finance, risk and business units, and streamline the required reporting for stress testing, which means banks will likely face significant modelling, data, and infrastructure challenges," explains Cayetano Gea-Carrasco, Global Practice Lead, Balance Sheet Management, Liquidity & Stress Testing at Moody's Analytics.

Moody's Analytics concludes that addressing the stress testing challenges will enable bank boards and senior management to make better-informed decisions, proactively create contingency plans, and help in understanding the evolving nature of risk in the banking business.

"A repeatable and consistent stress testing framework will lead to a more sound, lower-risk banking system with more efficient banks," adds Mr Gea-Carrasco.

Additional information on Moody's Analytics capabilities and thought-leadership around the AQR and stress tests can be found on [Moody's Analytics – Stress Testing Solutions](#).

About Moody's Analytics

Moody's Analytics helps capital markets and risk management professionals worldwide respond to an evolving marketplace with confidence. The company offers unique tools and best practices for measuring and managing risk through expertise and experience in credit analysis, economic research and financial risk management. By providing leading-edge software, advisory services and research, including proprietary analyses from Moody's Investors Service, Moody's Analytics integrates and customizes its offerings to address specific business challenges. Moody's Analytics is a subsidiary of Moody's Corporation (NYSE: MCO), which reported revenue of \$2.7 billion in 2012, employs approximately 6,800 people worldwide and has a presence in 28 countries. Further information is available at www.moodyanalytics.com.