3rd EBA Policy Research Workshop
"How to measure the riskiness of banks"

Discussion: Banking Stress Test Effects on Returns and Risks

Benjamin Friedrich, EBA

Overview of the article

- **Scope:** The article investigates the impact of announcement, publication of methodology and disclosure of results of stress tests on banks' equity prices, credit risk and systematic risk.
- **Data:** The analysis is based on US banking stress tests during the 2009-2013 period (SCAP, CCAR, DFAST).
- **Methodology:** Event study methodology is applied to CAR, credit spreads and changes in betas.
- **Contribution:** All US stress tests are included; the impact on betas is measured; and other disclosure events (announcement, methodology) in addition to the publication of results are included.
- **Results:** The authors find that stress tests after 2009 affected equity returns, CDS spreads and betas of large US banks:
  - Equity returns were higher after the publication of results but results were mixed regarding sign and significance (SCAP with largest effect);
  - CDS spreads declined after the publication of results but with similarly mixed results as for equity returns;
  - Betas generally declined (reduction in systemic risk).

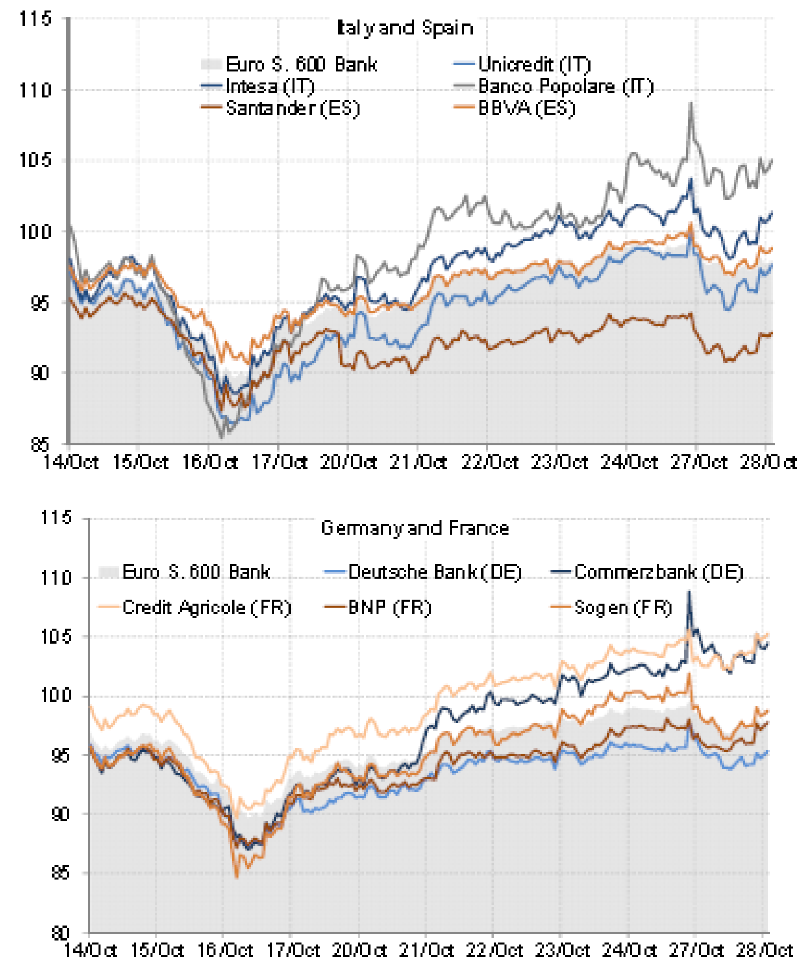
Policy implications

- The effect of the publication of the announcement, the methodology and results is a relevant question for all stress test exercises – usually focussing on equity prices and credit spreads / funding conditions:
    - Perception of stress tests by markets;
    - Decision on extent of disclosure.
- The article gives evidence on the relevance of stress test disclosure.
- The authors also describe methodologies found in the literature that can be employed to assess the impact of stress tests ex-post.

Example: Stress test published 26 October – initial market reactions and analyst assessments

- **Calm initial market reactions** and **limited volatility** on bank equity markets, stable CDS spreads. Some isolated name-specific volatility.
- **Benign initial reaction on bank funding markets.** Spread tightening for unsecured debt, especially 'peripheral' and subordinated debt.
- **Afterwards, more volatility.** The Euro Stoxx 600 banks decreased 2.99% in week two after publication. The 1-month change was around -0.6%. **Analysts awaited more details about the capital plans** of banks that failed the EU-wide stress test and volatility remained.
- Analysts widely regarded the exercise as **credible and thorough**. Similarity to US scenarios highlighted.
- Substantially **enhanced transparency** and unprecedented **scope of comparability** is highlighted.
- Clarity on adequacy of NPA recognition and **loan loss coverage** praised.
- Criticism on **missing elements** (leverage ratio, RWA harmonisation, capital floors on model usage, TLAC requirements).

Stock intraday performance of large EU banks



Comments and potential extensions

Results:

- Results give mixed signals – in particular SCAP shows by far the most significant impact and differing signs make an interpretation from a policy perspective difficult.
- More information of the SCAP event would be helpful, i.e. other factors driving the impact for that specific event.
- Some interpretations of results are difficult for the reader without references to fundamentals, i.e. effect on betas and systemic risks, how results are linked to extent of disclosure, results over different time periods.
- Results for different groups of banks defined by capitalisation levels ex-ante could be interesting.

Presentation:

- The article could benefit from some additional clarifications, e.g. on definitions used, data shown in the tables, to help the reader.

EBA

EUROPEAN
BANKING
AUTHORITY

EUROPEAN BANKING AUTHORITY

Tower 42, 25 Old Broad Street
London EC2N 1HQ

Tel: +44 2073821776
Fax: +44 207382177-1/2

E-mail: info@eba.europa.eu
http://www.eba.europa.eu