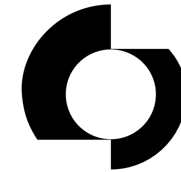


Hamburg Commercial Bank

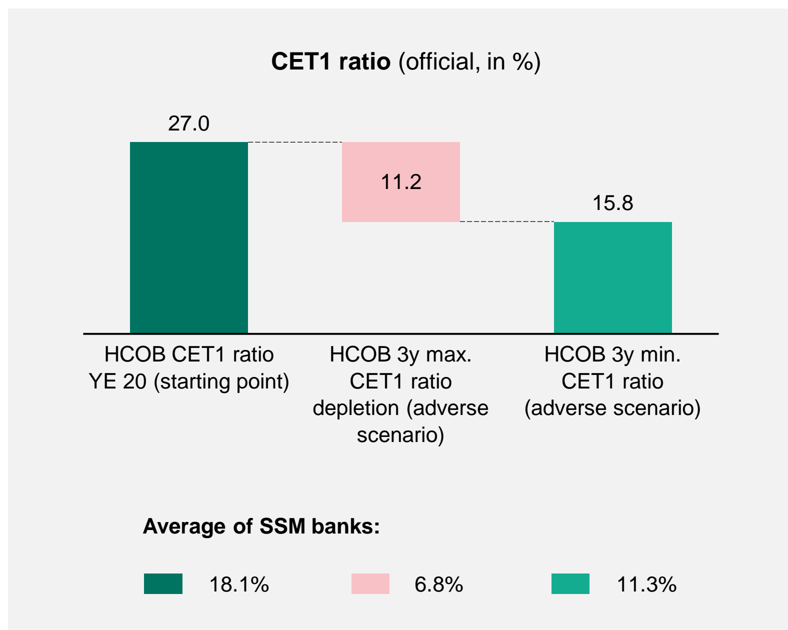
ECB stress test 2021

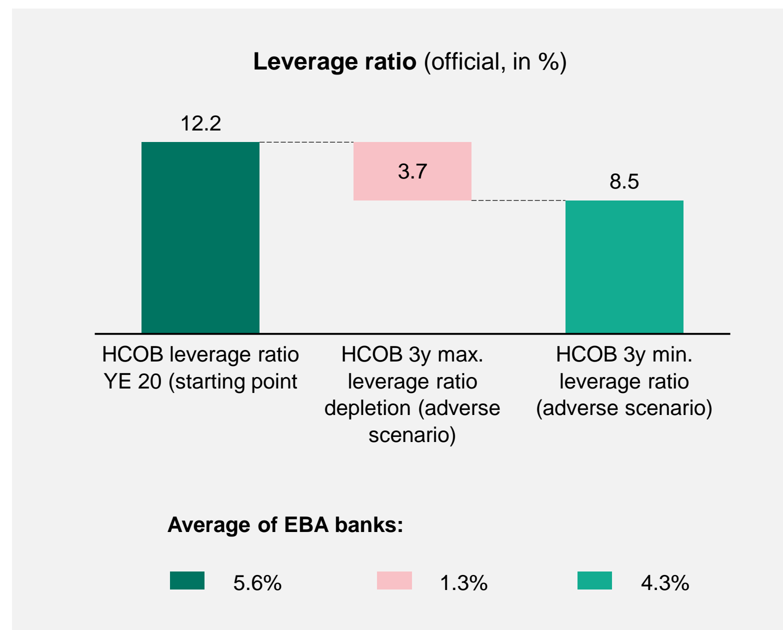
Communication of final results

Hamburg, 30th July 2021

HCOB with very high capital ratios in adverse case, but rate of capital depletion does not reflect the true state of transformation

- HCOB's ECB stress test results in a **3-year minimum CET1 ratio in the adverse scenario of nearly 16% and therefore ranging in the highest bucket** (> 14%) as well as **outstanding minimum leverage ratio of 8.5%** confirm HCOB's very solid capitalization, but the **maximum CET1 ratio depletion of 11.2% is rather pronounced** compared to other banks
- HCOB is convinced, that due to the given stress test methodology, **high CET1 depletion does not properly reflect the situation and development of the bank**. As the methodology does not take into account certain already completed or approved and in-process transformation measures, the currently shown impact of the stress test is significantly overstated for HCOB





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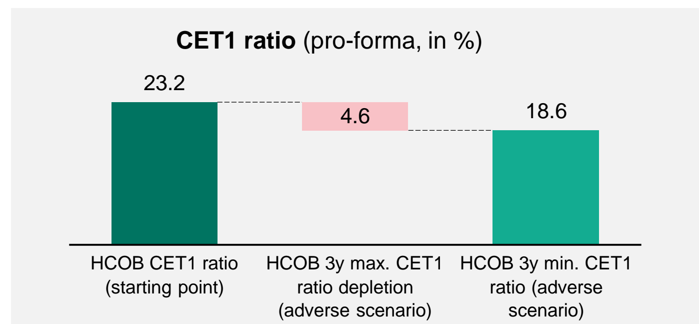
ECB stress test 2021 results do not fully reflect HCOB's transformation progress

- HCOB has made **significant progress at becoming a profitable bank as will be reflected in our H1 2021 figures**, which show improving profitability, not relying on one-off effects, but rather lower operating costs (operating and funding costs), stable revenues and higher margins. Most of these trends were already put on track by measures implemented in 2020 or earlier, but did not bear full fruit in 2020 P/L. Due to the methodological restriction of the stress test, this transformation progress is not reflected in the official results.



- Explicitly, the **already approved and partially implemented internal ratings based model changes** (Future Model Landscape) are not taken into account due to methodological restrictions as approval was only granted shortly after year end 2020. Additionally **HCOB's high starting CET1 ratio** leads to a higher stress test sensitivity: fully maintaining HCOBs official stress test impacts and only reducing the high level of excess capital to 15% would result in a significantly reduced CET1 ratio depletion. These methodologically induced issues alone would lead to a **reduction of the CET1 ratio depletion of more than 4%.**
- **Additionally, 1.5% depletion results from the static b/s assumption, which does not reflect state of transformation:** the stress test methodology being based on FY 2020 figures does not reflect the current position of HCOB, but **projects the weak core profitability and a weak earnings buffer of the past as well as legacy burdens, e.g. weak net trading income (NTI) into the future years.**
- This overestimation of CET1 depletion of 5.5% together with further minor issues was taken into account in a **'pro-forma' result**, which was officially communicated to ECB. It leads to a **total CET1 ratio depletion of only 4.6%** and better describes the current status of the bank as well as its resilience to adverse scenarios.

The ECB stated accordingly that the design of the stress test methodology limits the extent to which restructuring measures can be reflected in the results of the exercise[1]

1) ECB Disclaimer, published 30th July 2021: "In line with paragraph 11 of the EBA methodological note, banks included in the exercise that are under or near the completion of a restructuring have been subject to the same methodology, including the static balance sheet assumption, as other banks in the sample. This in turn limits the extent to which restructuring measures can be reflected in the result, e.g. regarding expected future restructuring benefits."

Background – ECB stress test 2021

Background

- **EU wide exercise:** EBA sample consists of 38 largest banks representing 70% of euro banking assets - additionally ECB conducts stress test for more than 50 banks directly supervised and not part of EBA sample (SSM banks, as HCOB)
- **Aims** – assess sufficiency of banks' capital buffers, foster market discipline, provide input for informed decisions on possible exit strategies from flexibility measures granted to banks due to Covid-19 crisis or the need of additional measures should economic conditions deteriorate further
- **Results** – EBA publishes results the 30th of July 21, ECB will disclose bank specific results in buckets (i.e. 'max. CET1 ratio depletion by ranges'). No pass / fail – however, results will be used to assess each bank's pillar 2 capital needs in the context of Supervisory Review and Evaluation Process

Very severe scenario

- The baseline scenario for EU countries is based on the projections from the national central banks of December 2020, while the adverse scenario assumes the materialisation of the main financial stability risks that have been identified by the European Systemic Risk Board (ESRB) and risk assessments by the EBA.
- The narrative depicts an **adverse scenario related to the ongoing concerns about the possible evolution of the COVID-19 pandemic coupled with a strong drop in confidence leading to a prolongation of the worldwide economic contraction** .The worsening of economic prospects is reflected in a global decline of long-term risk-free rates from an already historically low level and results in a sustained drop in GDP and an increase in unemployment. Slowing growth momentum would cause a drop in corporate earnings leading, together with a re-assessment of market participants' expectations, to an abrupt and sizeable adjustment of financial asset valuations as well as a significant drop in residential and commercial real estate prices. A decline in economic growth and rising risk premia could further challenge debt sustainability in the public and private sectors across the EU.
- The adverse scenario is designed to ensure an adequate level of severity across all EU countries. **By 2023, at EU level, the real GDP would decline by 3.6% cumulatively, unemployment rate would rise by 4.7 percentage points, residential real estate prices would decline by 16.1 %, and commercial real estate prices would decline by 31.2%. Equity prices in global financial markets would fall by 50% in advanced economies** and by 65% in emerging economies in the first year. **The 2021 adverse scenario is very severe** having in mind the weaker macroeconomic starting point in 2020 as a result of the severe pandemic-induced recession.

European Banking Authority (EBA)

Hamburg Commercial Bank