SOCIETE GENERALE

Letter to the editor, Financial Times, October 30, 2014

Alternative stress tests cannot compare with those of the ECB

Sir,

It is with puzzlement that we have read the column titled “Alternate stress tests hit French banks” published in Tuesday’s edition of the Financial Times. The column cast doubts on the credibility of the Comprehensive Assessment carried out by the European Central Bank and the European Banking Authority to assess the financial strength of Europe’s largest banks, based on a comparison of the stress tests with an alternate SRISK methodology devised by the Volatility Institute at New York University’s Stern School.

While we agree with the importance of looking at a range of different indicators to measure financial robustness, we are perplexed about the choice to give such disproportionate exposure to an 8-page academic study whose authors, however well-regarded, did not have access to the millions of data crunched by the 6,000- strong team of inspectors from the European Central Bank and national regulators who minutely sifted through the balance sheets of banks for nearly a year, and then submitted them to stress tests of an unprecedented severity. It is also difficult to understand why your story chose to focus on Societe Generale, when the NYU Stern School report doesn’t make any specific comment on Societe Generale, which does not appear as an outlier.

As headline-grabbing as the NYU/Stern findings may seem, the rationale underpinning the methodology of its stress tests is nothing new. The controversy over risk-weighted assets is increasingly yesterday’s debate, and it is fair to say that the Basel 3 framework, which encompasses both risk-weighted and non-risk-weighted capital measures, is now widely embraced across the world, even by those supervisors who at first expressed reservations against it. Societe Generale comes out with a “phased-in” Common Equity Tier 1 ratio of 8.1% in the EBA stress test under the adverse scenario, well above the minimum of 5.5% defined as a pass, and at 7.1%, in line with its European peers, based on the harsher metric of the “fully loaded” CET 1 ratio, which investors regard as the most reliable one.

By relying on a measure which attempts to avoid the complicated work – painstakingly carried out by the ECB – of evaluating the quality of bank assets and instead using public data such as accounting assets (using a very rough adjustment to approximate differences in accounting norms) and expressing them in proportion to market capitalization and equity price volatility, NYU’s “alternate” stress tests methodology unsurprisingly produces a very risk-insensitive metric, primarily driven by the size of accounting assets and the volatility of the share price. Why such an oversimplified and blunt approach should be deemed superior to the ECB’s careful line-by-line review of banks’ loan portfolios is mystifying. It gives little credit to the enormous work carried out by the ECB as it takes on its challenging mission as new single supervisor of the euro-zone banking industry, a key milestone for Europe.

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