

Box 12

SURVEY ON EU BANKS' LARGE EXPOSURES TO SINGLE-NAME CORPORATES

In the aftermath of the default of Parmalat, a relatively large Italian corporation, those EU banks with large exposures to the firm remained resilient, thereby mitigating the potential stresses on the financial system that could have arisen from such a large corporate failure. However, the episode raised the question of whether such resilience was actually an isolated event or a more

general feature of the EU banking system. To address this issue, the BSC undertook a survey in August and September 2005 to assess whether the idiosyncratic risk of large exposures to single-name corporates could be of concern from the perspective of the stability of EU banks, and to shed some light on prevailing risk management practices with respect to these exposures. This Box summarises the main findings of the survey. In view of the caveats in the survey's data and its limited and uneven sample, the survey findings can however only be considered as indicative, and any conclusions drawn are of necessity relatively provisional.

The survey was restricted to cover large exposures to single-name corporates of large EU banks. It considered an exposure to be large if in net terms it exceeded 5% of a bank's own funds. Respondents were asked to report all large exposures, on a consolidated basis and in net terms¹, for June 2004 and June 2005. In addition, a distinction was made between large exposures to non-financial corporates (NFC) and to non-bank financial corporates (NBFC). Large exposures to other banks, governments and public firms were excluded. The survey covered 38 large banks from seven EU Member States, with a total of 111 large exposures to NFC and 100 large exposures to NBFC.

The main finding of the report is that, measured in net terms, the bulk of EU banks' large exposures to single-name corporates falls substantially below the EU regulatory maximum limit of a large exposure (see Charts B12.1 and B12.2). This implies that EU banks, on average, set conservative limits for large exposures, which is generally recognised as an important precautionary measure in order to reduce the risk of an unacceptable increase in losses in the event of a large borrowing debtor default. In addition, most large EU banks, in preparation for the New Basel Accord, are developing and implementing economic capital models in order to measure and price large exposure risks on a systematic basis.

Even though the results may seem rather reassuring, complacency should nevertheless be avoided in assessing the risks of large exposures for large EU banks, for four reasons. First,

¹ In the report, a net exposure is defined as a "gross exposure net of collateral, guarantees and bad debt provisions against gross exposures, and after risk weighting" (cf. the Large Exposures Directive).

Chart B12.1 Distribution of large EU banks' large exposures to non-financial corporates

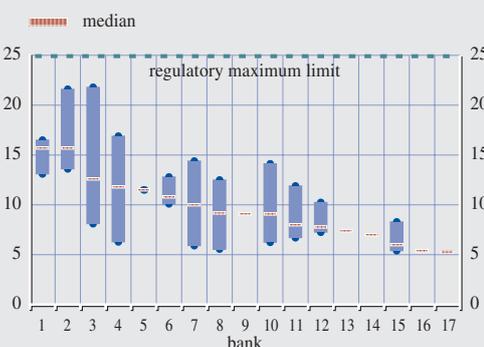
(June 2005, % of banks' own funds)



Source: BSC
Note: Based on 21 large banks from five EU Member States with in total 111 large exposures to NFC.

Chart B12.2 Distribution of large EU banks' large exposures to non-bank financial corporates

(June 2005, % of banks' own funds)



Source: BSC
Note: Based on 17 large banks from six EU Member States with in total 100 large exposures to NBFC.

significant differences exist among the sizes of large exposures across EU banks. While many banks have moderate or even zero large exposures, others were found to have very large exposures – net of collateral and guarantees – equalling or exceeding 15% of own funds. Second, there is some tentative evidence that certain banks are only marginally hedging their unsecured exposures, leaving them exposed to potentially large credit risks. However, the extent to which large EU banks in general are hedging large exposures using credit derivatives remains unclear, and these findings may point instead to some potential sources of risk at the individual institution level. Third, there are also some tentative signs that counterparty discipline might be under pressure as banks are keen to gain access, or maintain their positions, in the large lending market. Fourth, the analysis was restricted by data limitations, which for instance make it impossible to consider the extent to which large exposures of banks could be concentrated in the same counterpart, sector or region, or the impact of potential spillover effects.

In December 2005, Standard & Poor's² also called attention to the potential risks arising from high exposures to single-name firms at some European banks. The conclusions of this study were much more alarmist, citing “a number of instances in Europe where large single-name exposures to corporates are too high and could expose banks to unexpected shocks. This risk is even more acute when there is sector concentration among the top 20 exposures. Large single-name corporate exposures continue to weigh, therefore, on many bank ratings in Europe.” However, the results of this study and the BSC survey are not directly comparable owing to differences in the definitions, sample of banks and data sources used.

2 See Standard & Poor's (2005), “Lending concentrations linger at potentially risky levels at banks around the globe”, December.