

EBA 2021 Stress Test for Dutch Mortgages: A Tough Squeeze for the Orange



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Today's Speakers

Economics & Business Analytics



Luca Magni
Associate Director



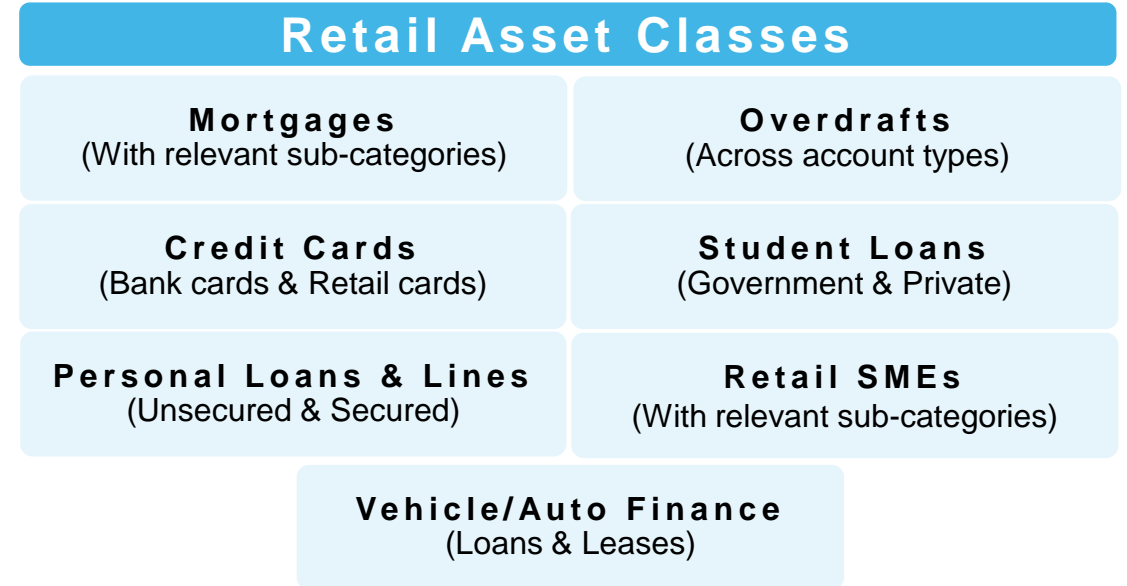
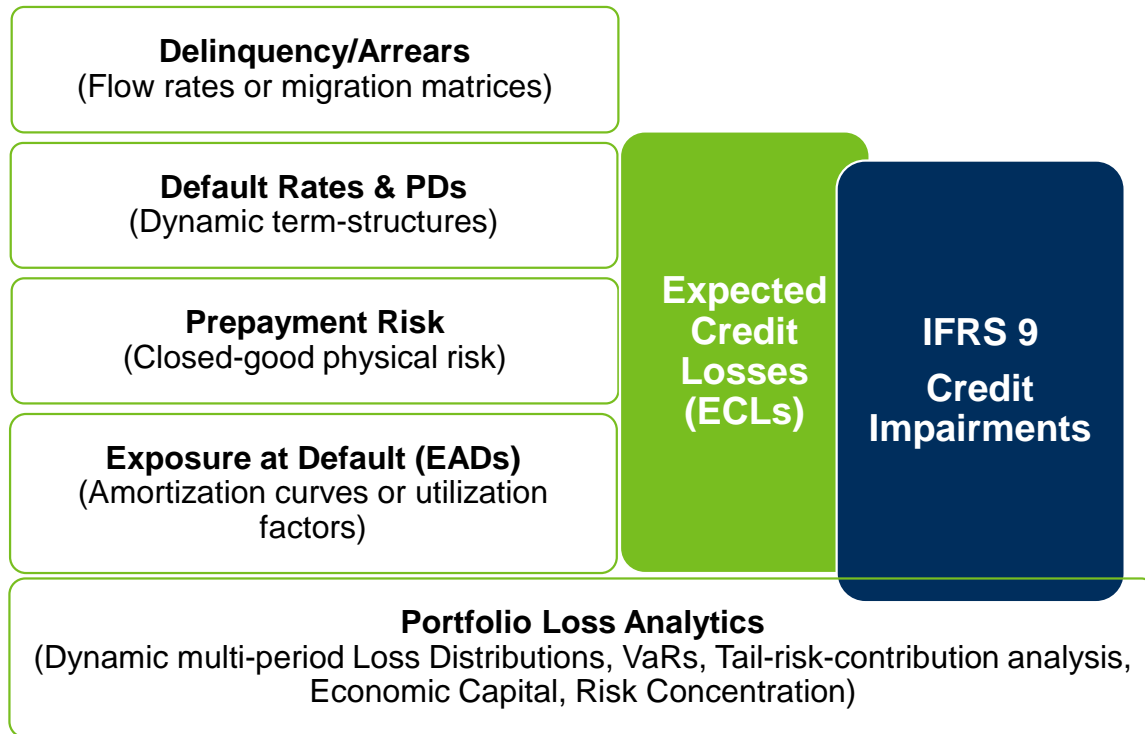
Petr Zemcik, PhD
Senior Director



Barnaby Black
Director

Portfolio Analyser (PA) Suite of Models

Retail loan-level econometric models for credit and impairment metrics



Webinar

1. EBA 2021 Stress Test
2. Dutch Representative Portfolio
3. Projections of PDs & LGDs
4. Forecasting EBA Risk Parameters
5. Capital Implications

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EBA 2021 Stress Test

EBA 2021 Stress Test

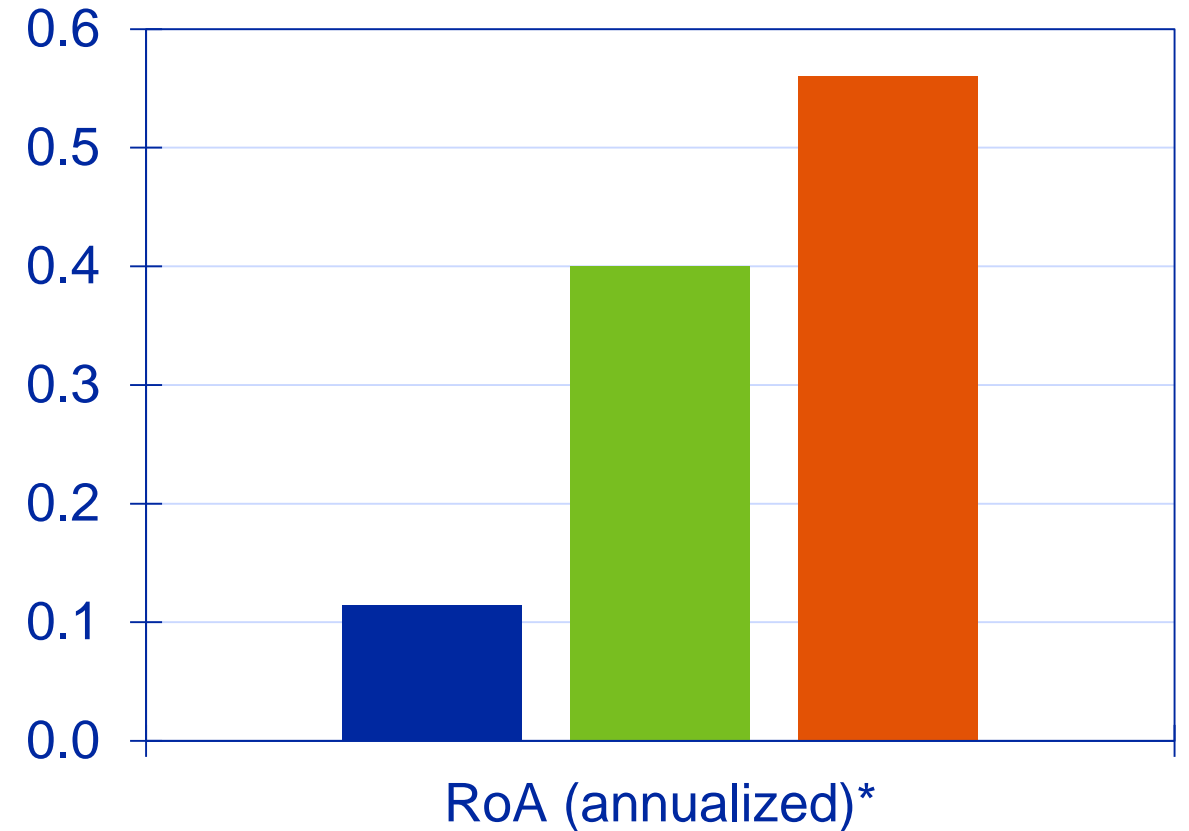
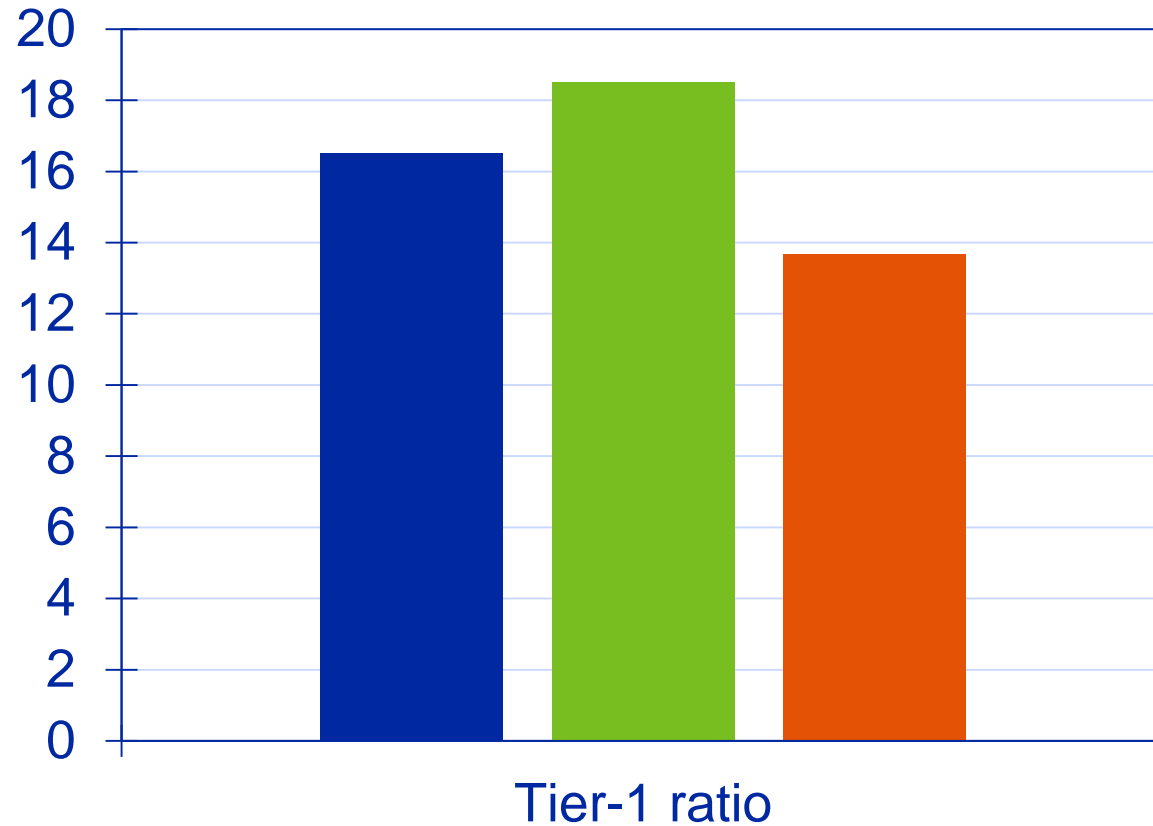
Introduction

- » Launched on January 29, 2021
- » The adverse scenario is based on a narrative of a prolonged COVID-19 scenario in a 'lower for longer' interest rate environment, in which negative confidence shocks would prolong the economic contraction
- » The adverse scenario reflects ongoing concerns about the possible evolution of the COVID-19 pandemic coupled with a potential strong drop in confidence;
- » The stress scenario is designed to ensure an adequate level of severity across all EU countries;
- » The EU-wide stress test is being conducted on a sample of 50 EU banks covering 70% of total banking assets in the EU
- » The EBA expects to publish the results of the exercise by 31 July 2021.

Banking Systems Stable, Profitability Low

Commercial banks, 2020Q3, %

■ Euro zone ■ U.K. ■ U.S.

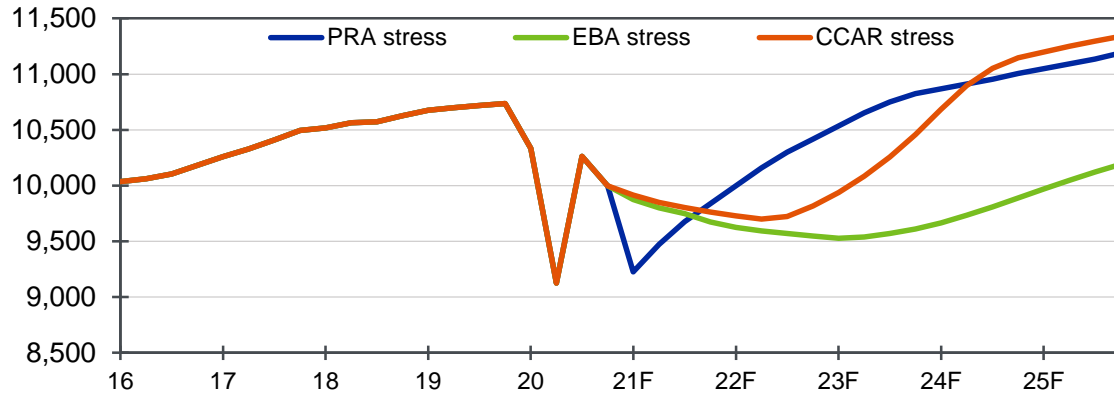


*as of 2020Q2 for euro zone and U.K.

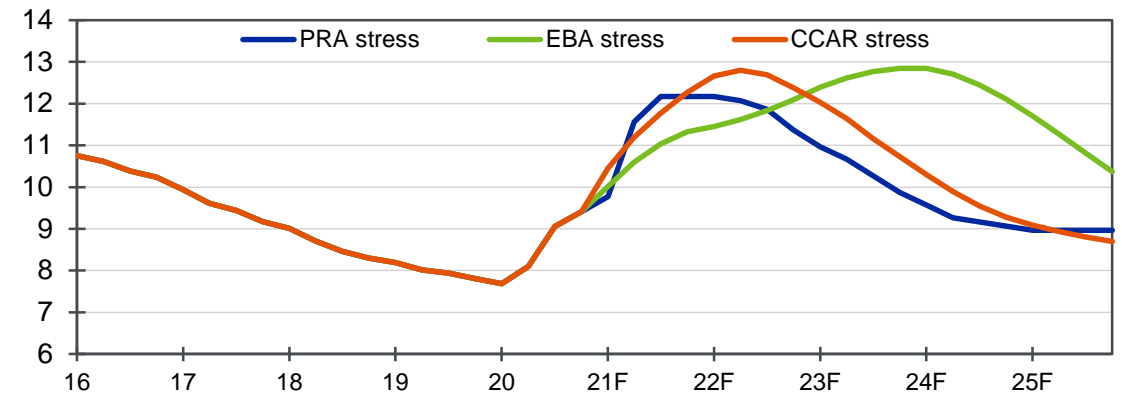
Sources: Fed, ECB, BoE, Moody's Analytics

Euro Zone Stress Test Scenario Forecasting

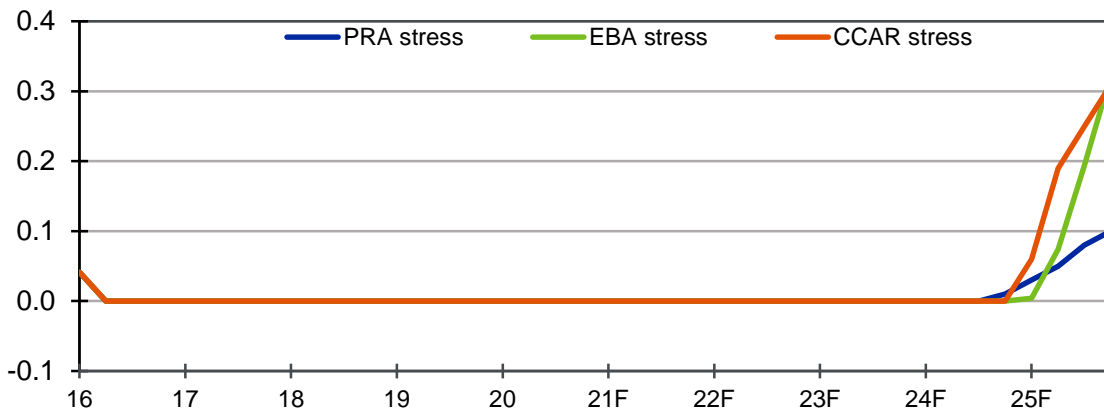
Real GDP, Bil. Ch. 2010 EUR, CDASAAR



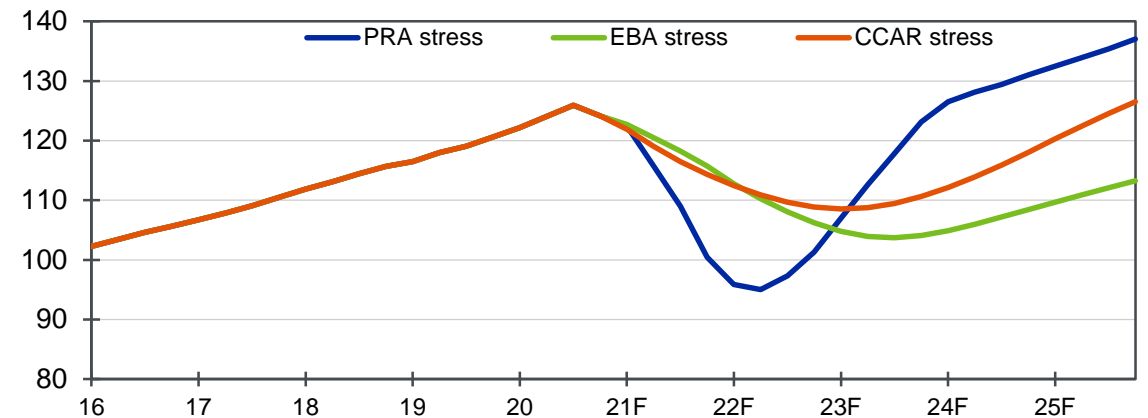
Unemployment Rate, %



Monetary Policy Rate, %



House Price Index, Index 2015=100, SA



Sources: Fed, EBA, PRA, Moody's Analytics

Macroeconomic Drivers

EBA Projections

Real GDP

		Historical growth (%)	Baseline growth (%)			Adverse growth (%)			Cumulative growth from the starting point(%)	Minimum growth from the starting point growth (%)	Level deviation 2023 (%)
		2020	2021	2022	2023	2021	2022	2023			
Netherlands	NL	-4.3	2.9	2.9	1.9	-1.3	-2.3	-0.6	-4.3	-4.3	-11.3
Euro area	EA	-7.3	3.9	4.2	2.1	-1.5	-1.9	-0.2	-3.6	-3.6	-12.9
European Union	EU	-6.9	3.9	4.2	2.3	-1.5	-1.9	-0.2	-3.6	-3.6	-12.9

Unemployment rate

		Historical value (%)	Baseline rate (%)			Adverse rate (%)			Cumulative growth from the starting point	Maximum growth from the starting point growth (p.p.)	Level deviation 2023 (p.p.)
		2020	2021	2022	2023	2021	2022	2023			
Netherlands	NL	4.0	6.5	6.0	4.6	7.0	9.5	10.0	6.0	6.0	5.4
Euro area	EA	8.0	9.3	8.2	7.5	10.4	11.5	12.4	4.5	4.5	4.9
European Union	EU	7.4	8.7	7.7	7.1	10.0	11.2	12.1	4.7	4.7	5.0

Note: The tables reports annual averages.

Note: Projections from the NCBs are used as baseline forecasts for EU countries. For non-EU countries, the baseline projections are based on projections from the October 2020 IMF WEO.

Real Estate Prices & Interest Rates

EBA Projections

Residential real estate prices

		Historical growth (%)	Baseline growth (%)			Adverse growth (%)			Cumulative growth from the starting point(%)	Minimum growth from the starting point growth (%)	Level deviation 2023 (%)
		2020	2021	2022	2023	2021	2022	2023			
Netherlands	NL	7.1	2.0	1.1	2.5	-4.4	-9.8	-5.5	-18.5	-18.5	-22.9
Euro area	EA	4.7	2.1	2.1	2.8	-3.9	-8.2	-4.5	-15.7	-15.7	-21.4
European Union	EU	4.9	2.2	2.1	2.9	-3.9	-8.4	-4.7	-16.1	-16.1	-21.9

Long-term interest rates

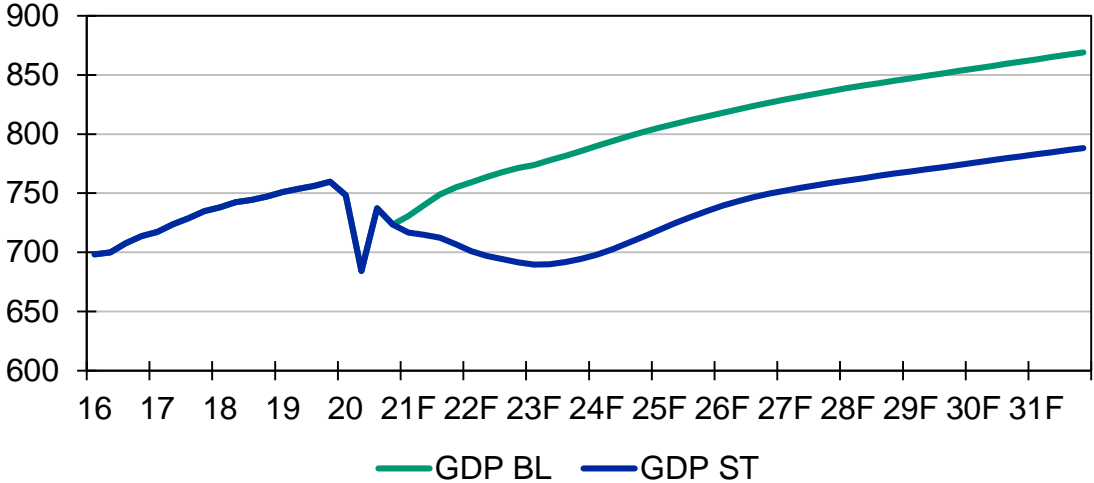
		Starting point rates (%)	Baseline rates (%)			Adverse rates (%)		
		2020	2021	2022	2023	2021	2022	2023
Netherlands	NL	-0.32	-0.43	-0.36	-0.28	-0.96	-0.64	-0.64
Euro area	EA	0.04	-0.11	0.01	0.13	0.02	0.17	0.18
European Union	EU	0.18	0.01	0.13	0.24	0.61	0.73	0.71

Note: The tables reports annual averages.

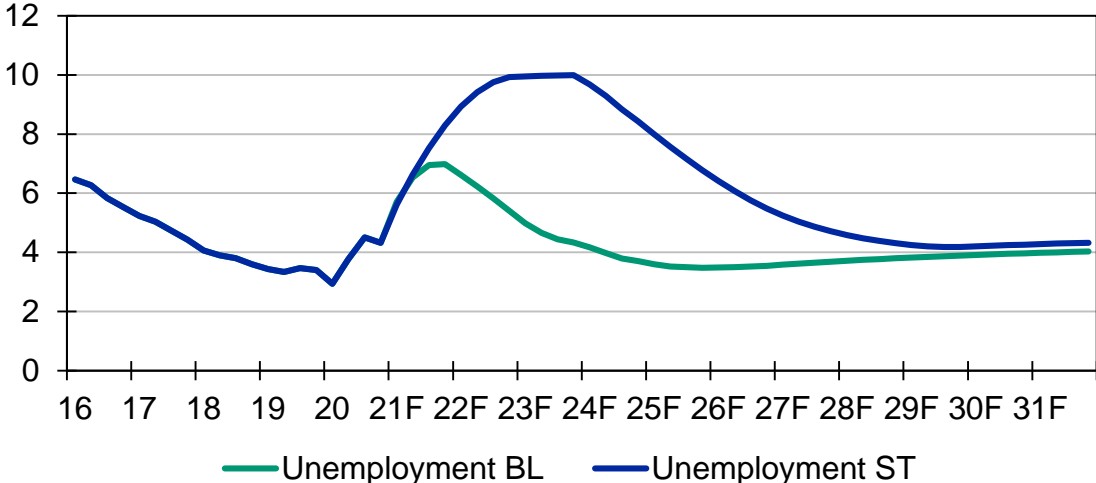
Note: For real estate prices, projections from the NCBs are used as baseline forecasts for EU countries. For non-EU countries, the baseline projections are based on projections from the October 2020 IMF WEO.

Netherlands Forecasts

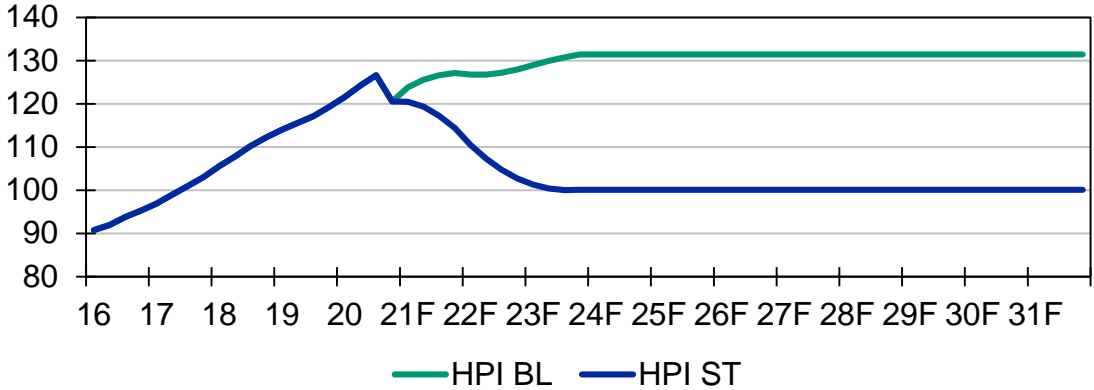
GDP



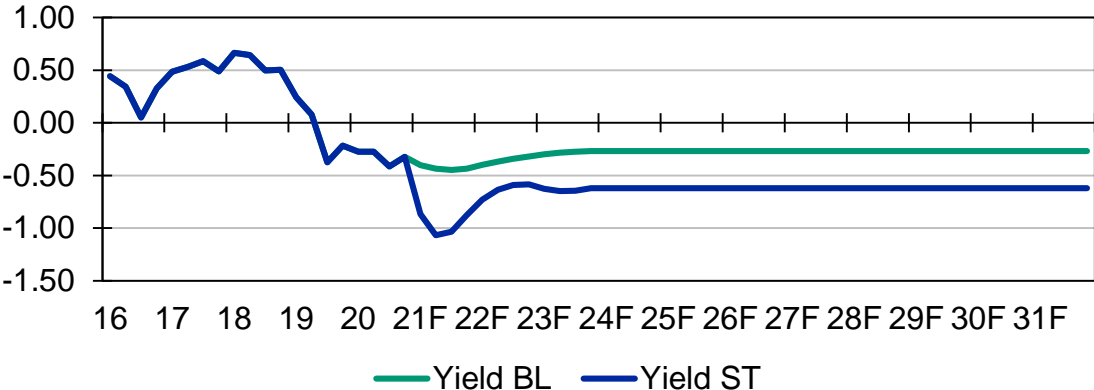
Unemployment



HPI



10Y Yield

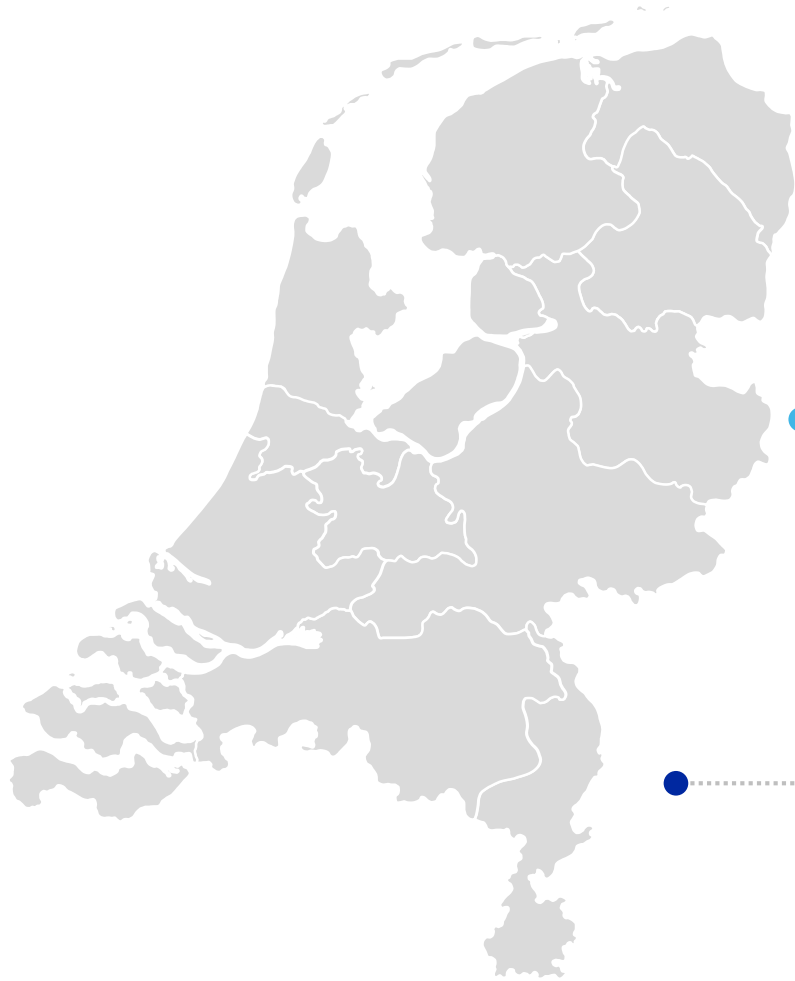


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Dutch Representative
Portfolio

Rich Loan-level & Regional Macroeconomic Data

For more than 2M master loans & 3.8M loan parts, EDW



Borrower characteristics

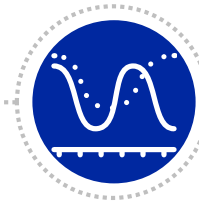
Employment status, primary/secondary income, borrower age and income



Loan characteristics & performance

Mortgage type, payment type, loan-to-value, interest rate, loan term, origination balance, purchase price, occupancy/property/purpose type, geographic region, NHG guarantee

Monthly remaining balance, arrears status, prepayment, current interest rate and default date.

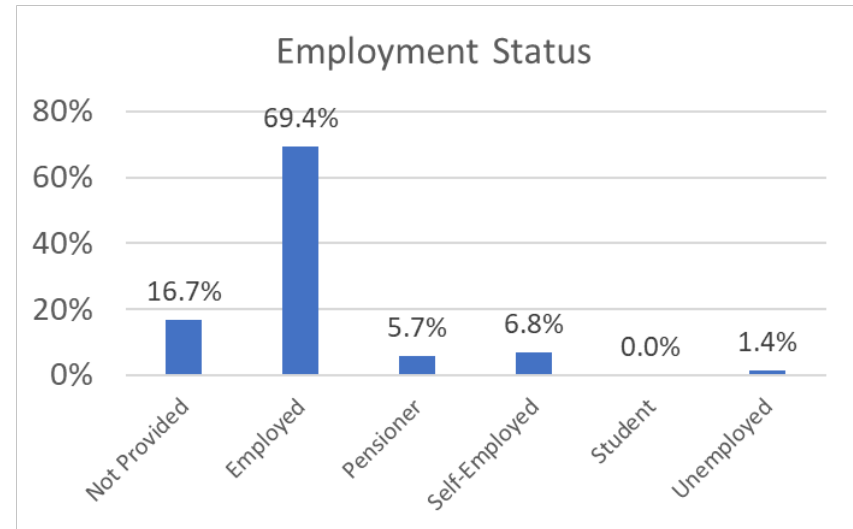
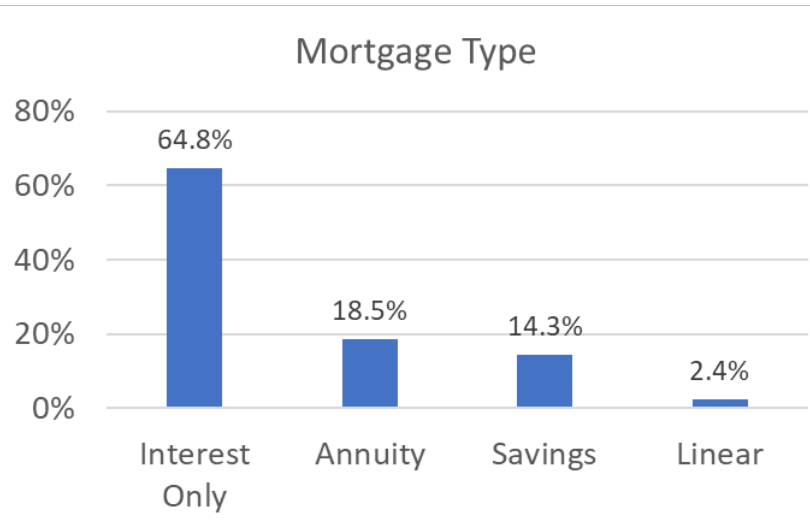
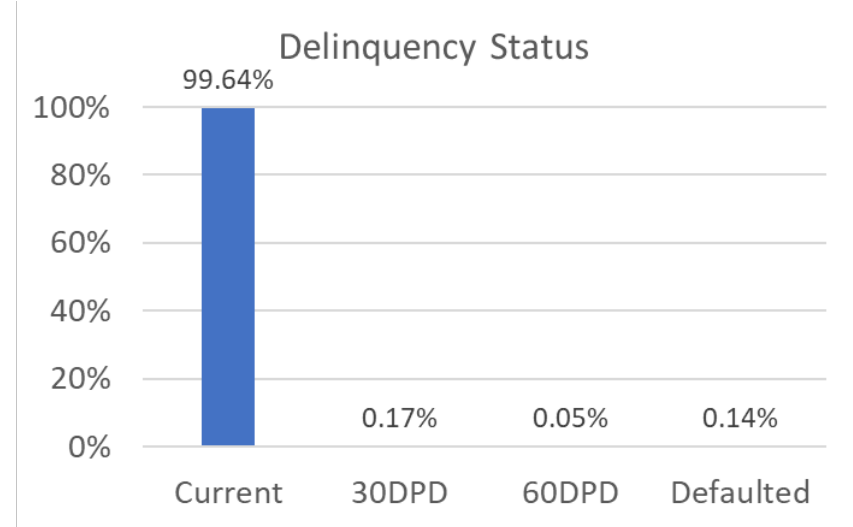
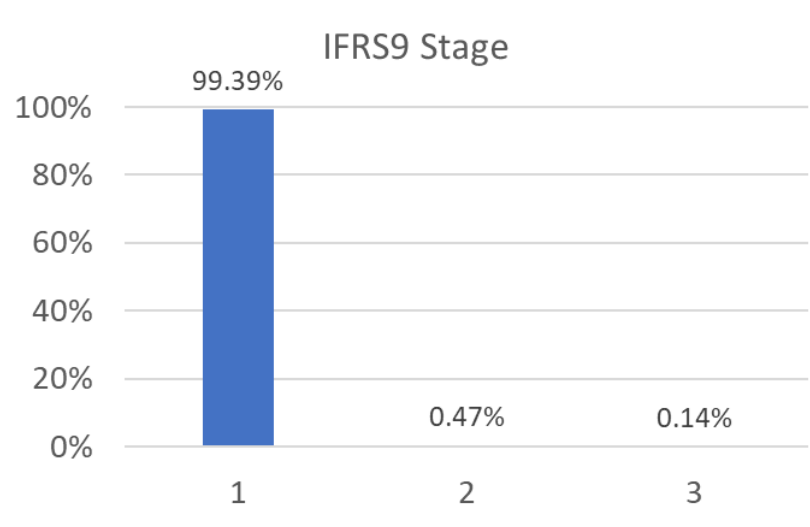


Macroeconomic data

Home prices, unemployment, interest rates

December 2020 Data – Characterizing the loans

- » The data available consists of 818,653 mortgages totaling an outstanding balance of EUR 71,891,011,230.
- » There are 1,150 non-performing loans, which represents 0.14% of the book.
- » 64.8% of mortgages are interest only. Most other mortgages are either annuity or savings mortgages.
- » Nearly 70% of customers are employed, whilst an additional 6.8% are self-employed and 5.7% are pensioners.

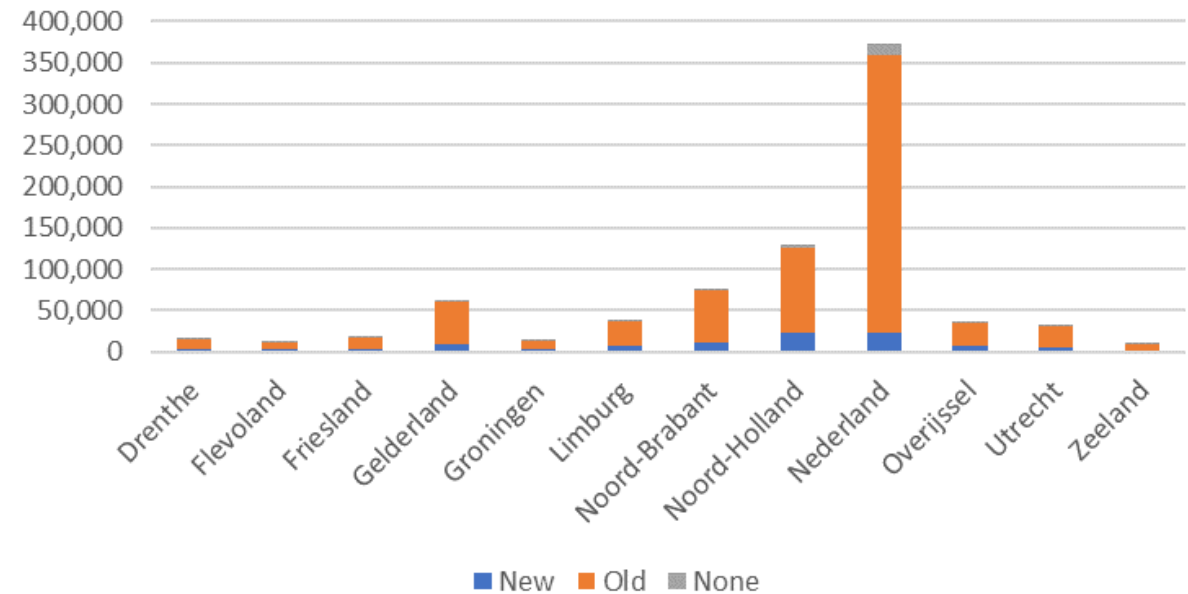


December 2020 Data – NHG Indicator by Province

NHG Indicator

Province	New	None	Old	
Drenthe	3,175	12,298	716	16,189
Flevoland	2,732	7,918	451	11,101
Friesland	3,574	13,281	786	17,641
Gelderland	9,677	51,024	1,906	62,607
Groningen	3,163	10,189	1,099	14,451
Limburg	7,312	29,745	1,903	38,960
Noord-Brabant	10,743	63,713	2,380	76,836
Noord-Holland	23,546	101,883	4,538	129,967
Nederland	22,649	336,577	14,280	373,506
Overijssel	6,573	27,770	1,360	35,703
Utrecht	4,567	27,231	901	32,699
Zeeland	1,652	7,075	266	8,993
	99,363	688,704	30,586	818,653

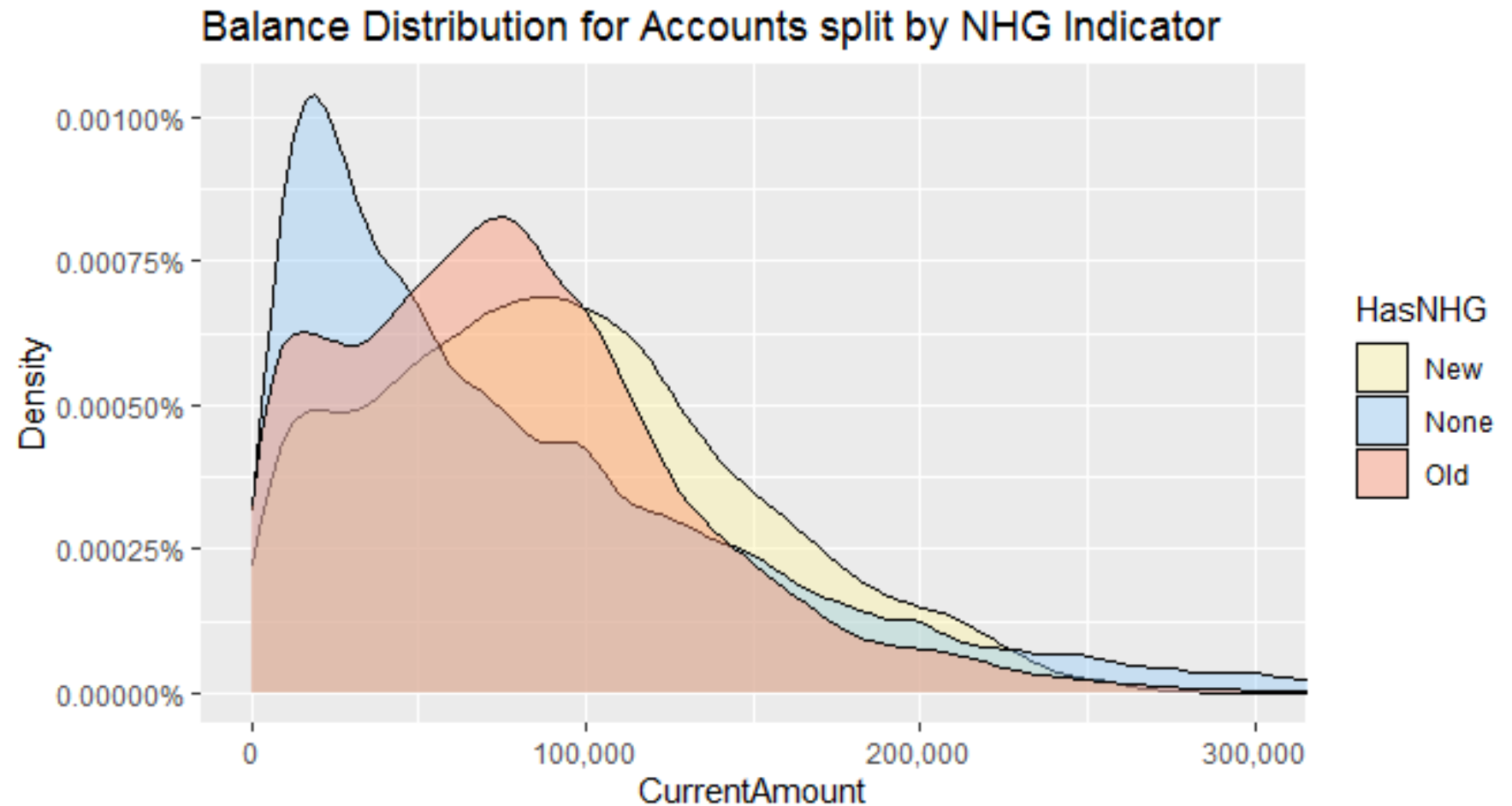
Accounts split by Province and NHG Indicator



"New" means NHG is after Jan 2013 and is under new coverage rule.
 "Old" means NHG belongs to amortizing regime of pre-2013 policies.

December 2020 Data – Balance Distribution by NHG Indicator

- » There is a clear variation between the balance distributions of accounts with and without NHG.
- » Larger balances typically appear on NHG accounts.
- » There is little difference between the distributions of old and new NHG accounts. The variation here is attributable to the age difference between portfolios.



December 2020 Data– LTV Analysis

- » Non-NHG accounts have a notably lower average LTV, which appears logical given the lower balance distribution seen on the previous slide.
- » Again, there is little variation between old and new NHG accounts.
- » There is also little variation between the LTVs of IFRS9 stages 2 and 3, with volatility in the figures explaining any differences here.

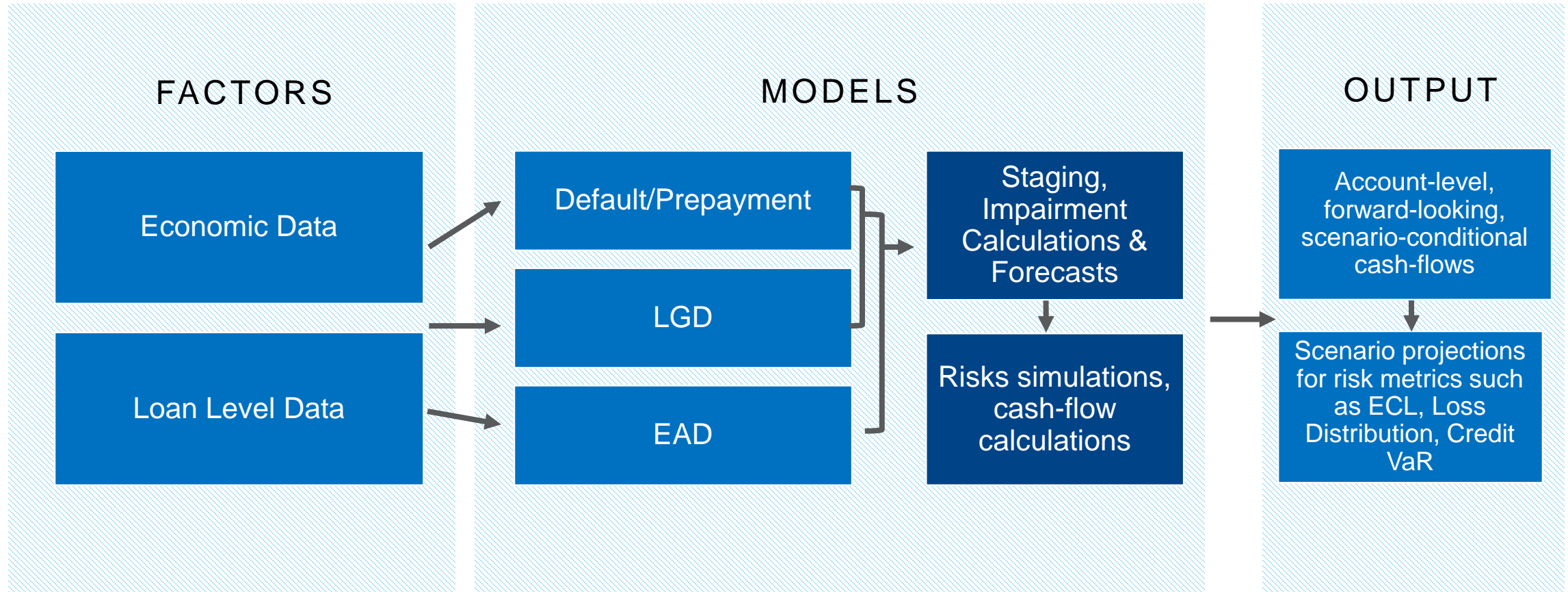
NHG Indicator	IFRS9 Stage		
	1	2	3
None	68.6%	98.5%	100.8%
Old	96.0%	106.3%	103.0%
New	95.0%	102.1%	101.7%

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Projections of PDs & LGDs

Modular Structure for Consumer Loans Analysis

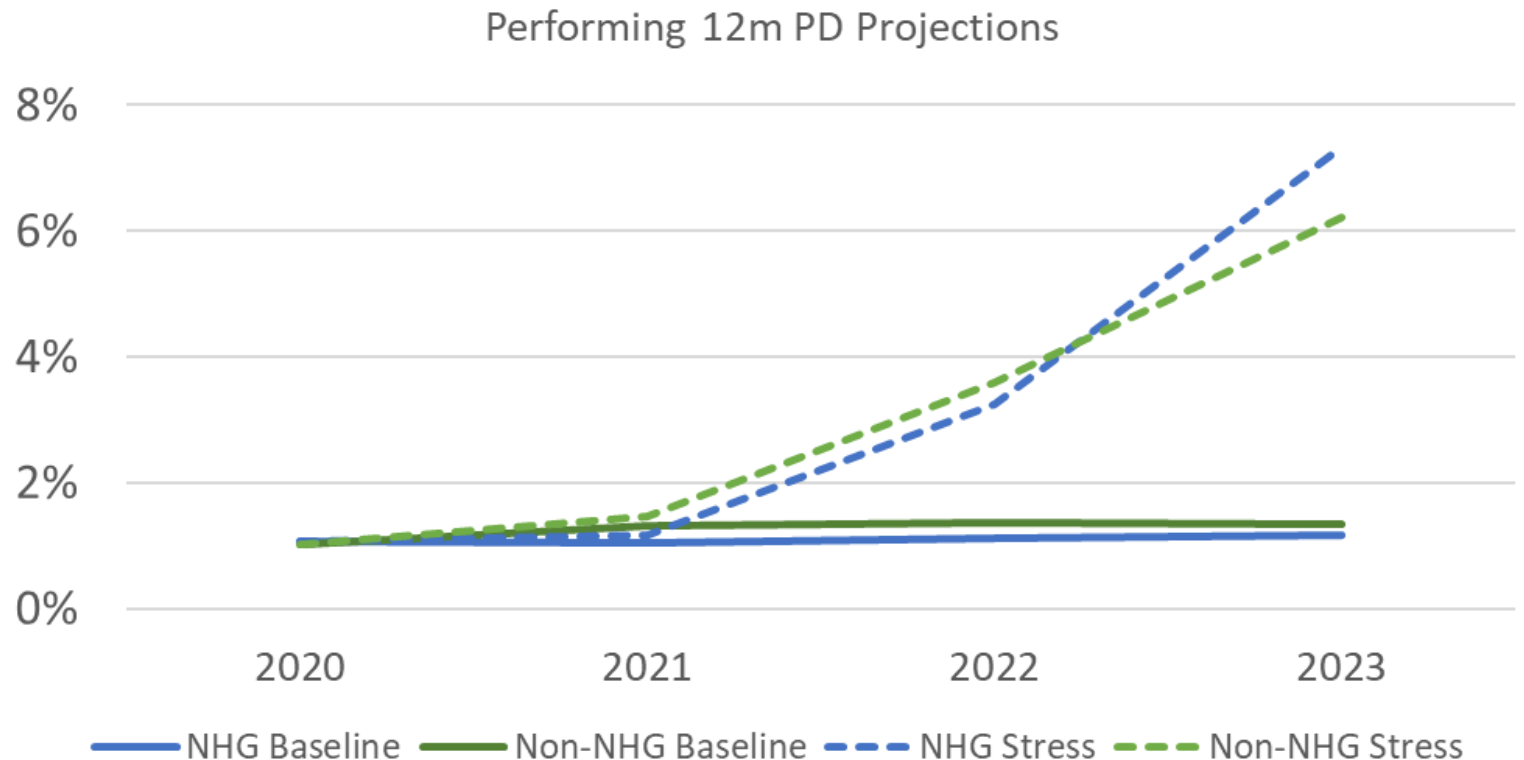
The case of Dutch Mortgages using Moody's MPA



Data with Projections – 12-month PD Analysis

Data split by accounts with and without NHG

- » Here we plot 12-month PD projections over the next three years.
- » Under the EBA Baseline, the rates remain relatively stable throughout the forecast period. There is little variation in the rates between accounts with and without an NHG.
- » Under the EBA Stress scenario, the PD increases significantly for both portfolios in 2022 as unemployment spikes. Based on the macroeconomic scenario, PDs would not be expected to return to pre-pandemic levels until towards the end of the decade.



Data with Projections - LGD Distribution

Including 2023 projections

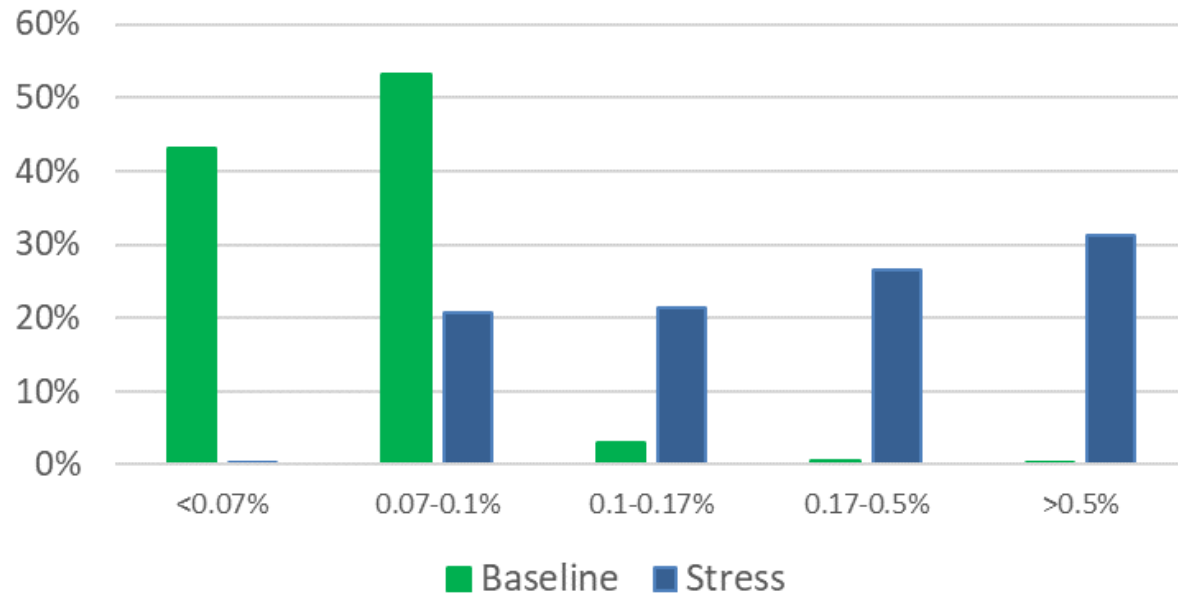
- » The distribution of LGDs in December 2020 is displayed as the blue series.
- » Under a Baseline scenario, the distribution (green) is projected to shift into lower LGD bands
- » Under the EBA's stress scenario, the distribution (orange) is projection to shift into higher LGD bands.



Simulations – Distribution of Expected Losses

3Y Expected Loss – VaR Approach

Distribution of 3Y Expected Loss



Dutch MPA – EBA Baseline

Loss Summary Baseline

Expected Loss 0.0743

Aggregate Statistics Baseline

Simulations 10,000
 Mean 0.0743
 SD 0.0223
 IQR 0.0117
 Skewness 10.9183
 Kurtosis 190.21
 95th/50th Pct 1.3642

Value-at-Risk Baseline

50% 0.0704
 75% 0.0771
 90% 0.0863
 95% 0.0961

Dutch MPA – EBA Adverse

Loss Summary Adverse

Expected Loss 1.2597

Aggregate Statistics Adverse

Simulations 10,000
 Mean 1.2597
 SD 3.1804
 IQR 0.6340
 Skewness 4.8416
 Kurtosis 28.1211
 95th/50th Pct 29.1676

Value-at-Risk Adverse

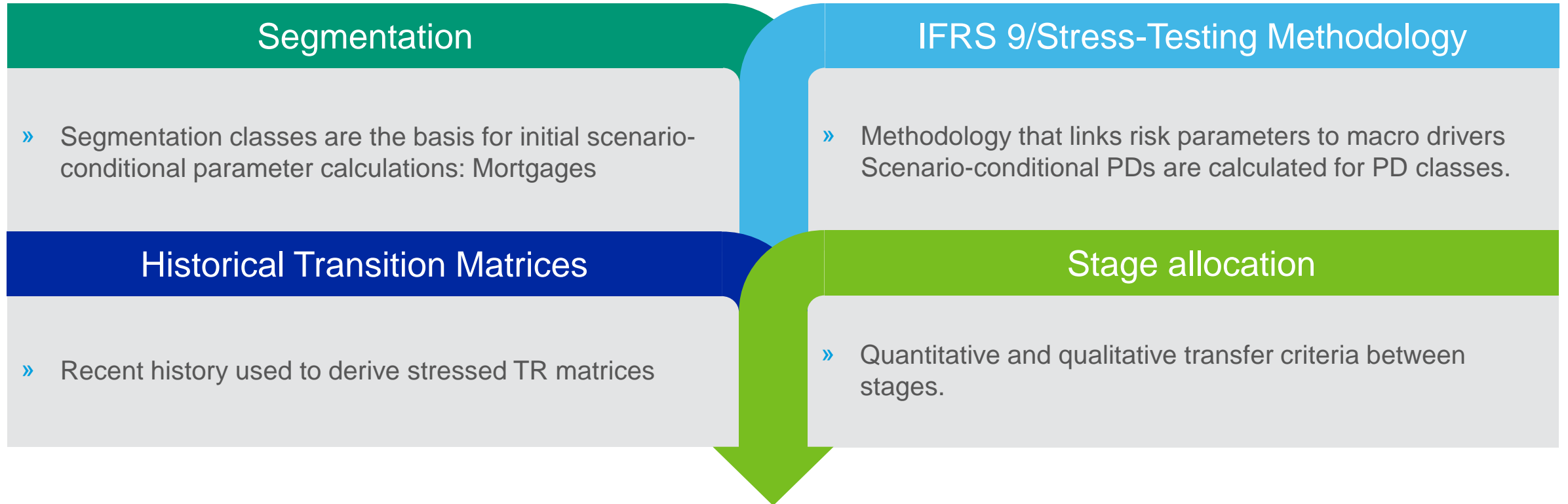
50% 0.2205
 75% 0.7457
 90% 2.9703
 95% 6.4302

4

Forecasting EBA Risk
Parameters

Impairment Forecasting Inputs

Account-Level Projections



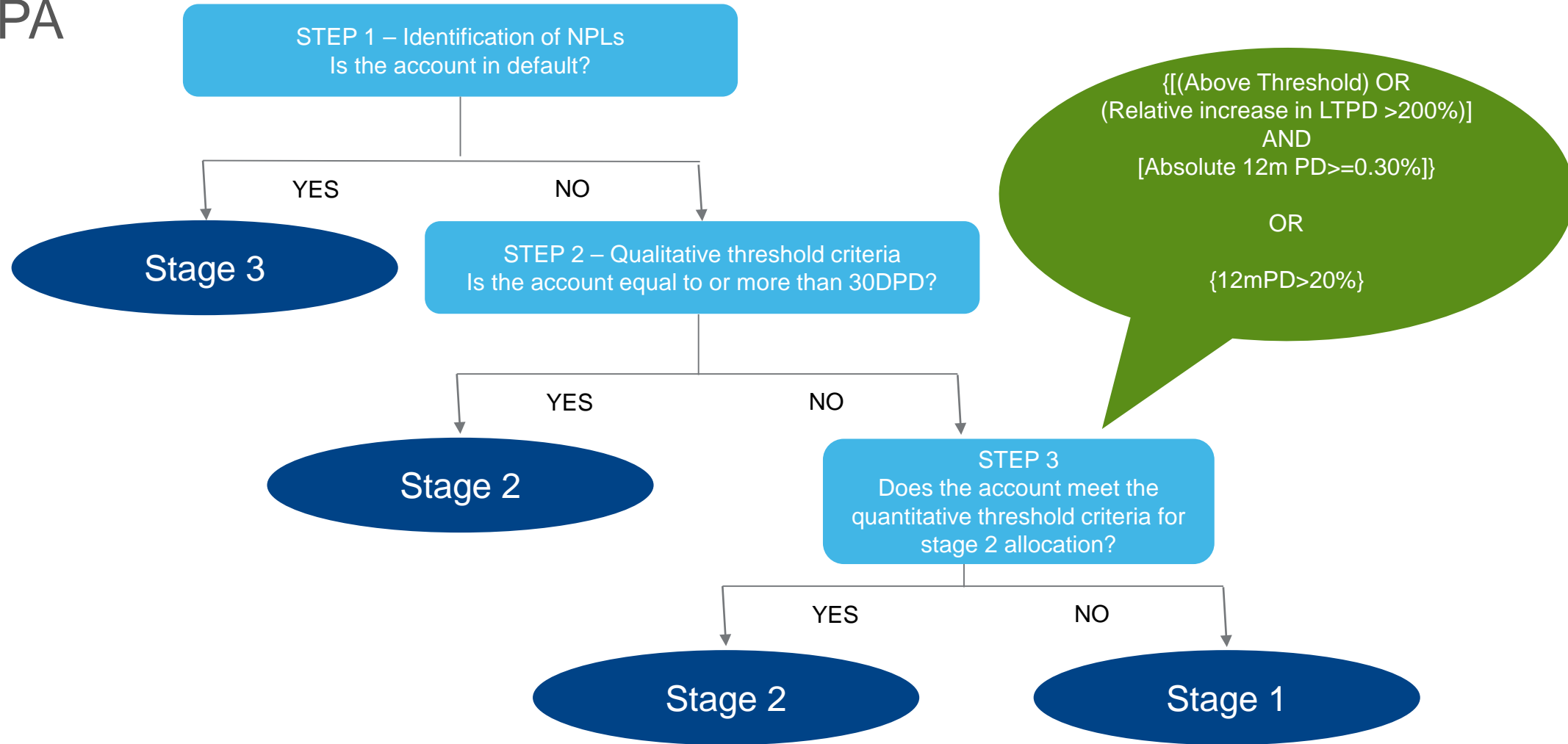
Forecasting Impairments

Key Steps

- » Obtain a through-the-cycle transition matrix
- » Construct a point-in-time transition matrix conditional on economic drivers using the Z-factor shift approach
- » Estimate Starting Parameters
- » Forecast the staging distribution
- » Forecast the delinquency status distribution
- » Calculate lifetime expected loss rates

Stage Allocation

Dutch MPA



Conditional Transition Matrix

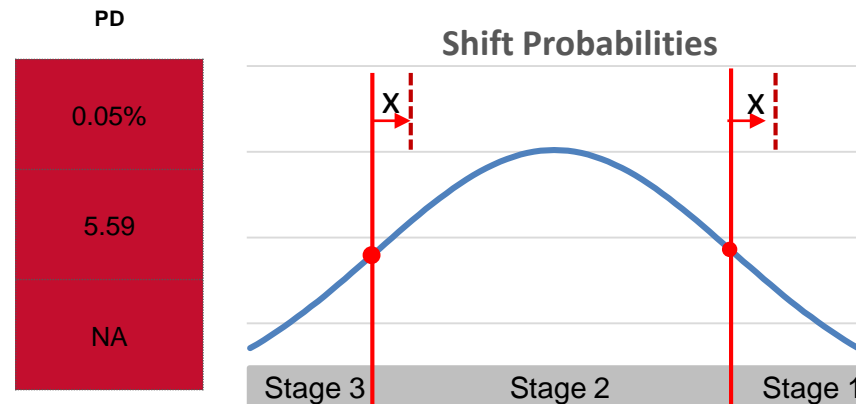
Constructing a PiT Transition Matrix – Starting Parameters

TTC TR

	Stage 1	Stage 2	Stage 3
Stage 1	99.08%	0.75%	0.17%
Stage 2	28.82	68.72	2.36
Stage 3	0%	0%	100.00%

- » Historical data summarized into through-the-cycle transition matrix

Conditional PD



- » PDs are implied by the IFRS 9/Stress testing methodology
- » Transition probabilities are assumed to make a parallel shift in inverse normal distribution space: Z-factor approach

PiT TR

	Stage 1	Stage 2	Stage 3
Stage 1	99.72 %	0.23%	0.05%
Stage 2	19.37	75.04	5.59
Stage 3	0%	0%	100%

- » Transition matrix conditional on a stress scenario
- » Determines EBA risk parameters TR1-2 and TR1-3

Parameter Projections

NHG

Starting Point Parameters	
TR 1-3	0.05%
TR 1-2	0.23%
TR 2-1	19.37%
TR 2-3	5.59%
LGD 1-3	4.53%
LGD 2-3	5.37%
Cure 1-3	0.00%
Cure 2-3	0.00%
LRLT 1-2	0.08%
LRLT 2-2	0.45%
LRLT 3-3	3.66%

	2021	2022	2023
EBA - Baseline Parameters			
TR 1-3	0.056%	0.056%	0.055%
TR 1-2	0.235%	0.236%	0.233%
TR 2-1	22.334%	20.606%	19.710%
TR 2-3	4.517%	5.109%	5.452%
LGD 1-3	3.055%	2.268%	1.112%
LGD 2-3	6.347%	3.165%	3.448%
Cure 1-3	0.000%	0.000%	0.000%
Cure 2-3	0.000%	0.000%	0.000%
LRLT 1-2	0.064%	0.060%	0.047%
LRLT 2-2	0.358%	0.320%	0.253%
LRLT 3-3	4.743%	3.955%	3.192%
EBA - Baseline Benchmark			
TR 1-3	4.900%	5.300%	4.100%
TR 1-2	5.000%	5.100%	4.700%
TR 2-1	20.100%	19.700%	21.300%
TR 2-3	9.800%	10.400%	8.400%
LGD 1-3	32.958%	32.958%	32.958%
LGD 2-3	39.782%	39.782%	39.782%
Cure 1-3	NA	NA	NA
Cure 2-3	NA	NA	NA
LRLT 1-2	8.300%	6.500%	5.200%
LRLT 2-2	10.000%	7.900%	6.200%
LRLT 3-3	NA	NA	NA

	2021	2022	2023
EBA - Adverse Parameters			
TR 1-3	0.06%	0.17%	0.33%
TR 1-2	0.26%	0.60%	1.02%
TR 2-1	21.13%	9.41%	3.92%
TR 2-3	4.92%	12.74%	24.37%
LGD 1-3	4.71%	3.87%	4.50%
LGD 2-3	<u>6.31%</u>	5.81%	4.31%
Cure 1-3	0.00%	0.00%	0.00%
Cure 2-3	0.00%	0.00%	0.00%
LRLT 1-2	0.86%	1.20%	1.73%
LRLT 2-2	0.81%	1.12%	1.24%
LRLT 3-3	4.74%	5.53%	5.05%
EBA - Adverse Benchmark			
TR 1-3	5.80%	10.30%	7.20%
TR 1-2	5.30%	6.40%	5.60%
TR 2-1	19.00%	15.50%	17.80%
TR 2-3	11.40%	18.40%	13.60%
LGD 1-3	45.56%	45.56%	45.56%
LGD 2-3	52.99%	52.99%	52.99%
Cure 1-3	NA	NA	NA
Cure 2-3	NA	NA	NA
LRLT 1-2	17.80%	13.40%	10.00%
LRLT 2-2	20.80%	15.60%	11.70%
LRLT 3-3	NA	NA	NA

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Capital Implications

Capital Overview

Introduction

- » Moody's Analytics provide IFRS9 impairment modelling solutions to a range of institutions, with models provided in Moody's Portfolio Analyzer (MPA).
- » Standardised, foundation or advanced IRB capital calculations under current and future Basel accords can also be provided, dependant on the specifications provided by the institution.
- » There are many benefits of calculating capital alongside impairment:
 1. Capital analysis would provide insight into the portfolio using a default template with graphs that could be customised
 2. Providing impairment and capital calculations in the same place allows for clients to understand if there are tranches where they are underproviding for expected losses
 3. Predict future capital requirements under alternative macroeconomic conditions for...
 - a) Stress testing a range of scenarios
 - b) Population of regulatory templates (i.e. EBA stress test)
 - c) Reverse stress testing

REA Impact Assessment

Standardized Approach

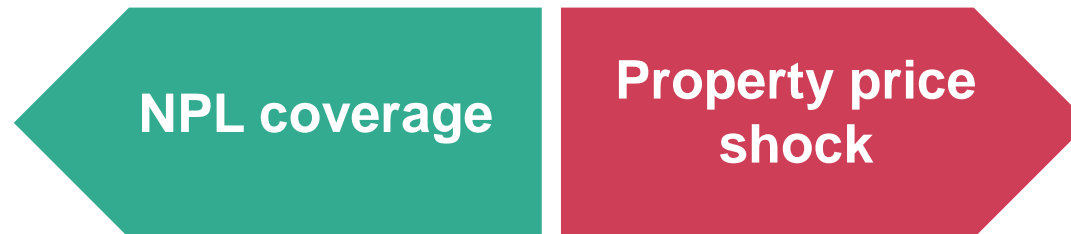
Main Drivers of Stressed REA

Higher LLPs imply lower net exposures, thus, lower REA



Higher NPLs imply more exposures that are risk weighted at 100% / 150%

Higher NPL coverage ($\geq 20\%$), more exposures weighted at 100% vs 150%



Decline in property prices reduces exposure subject to 35% risk weight

Risk Weight Projections

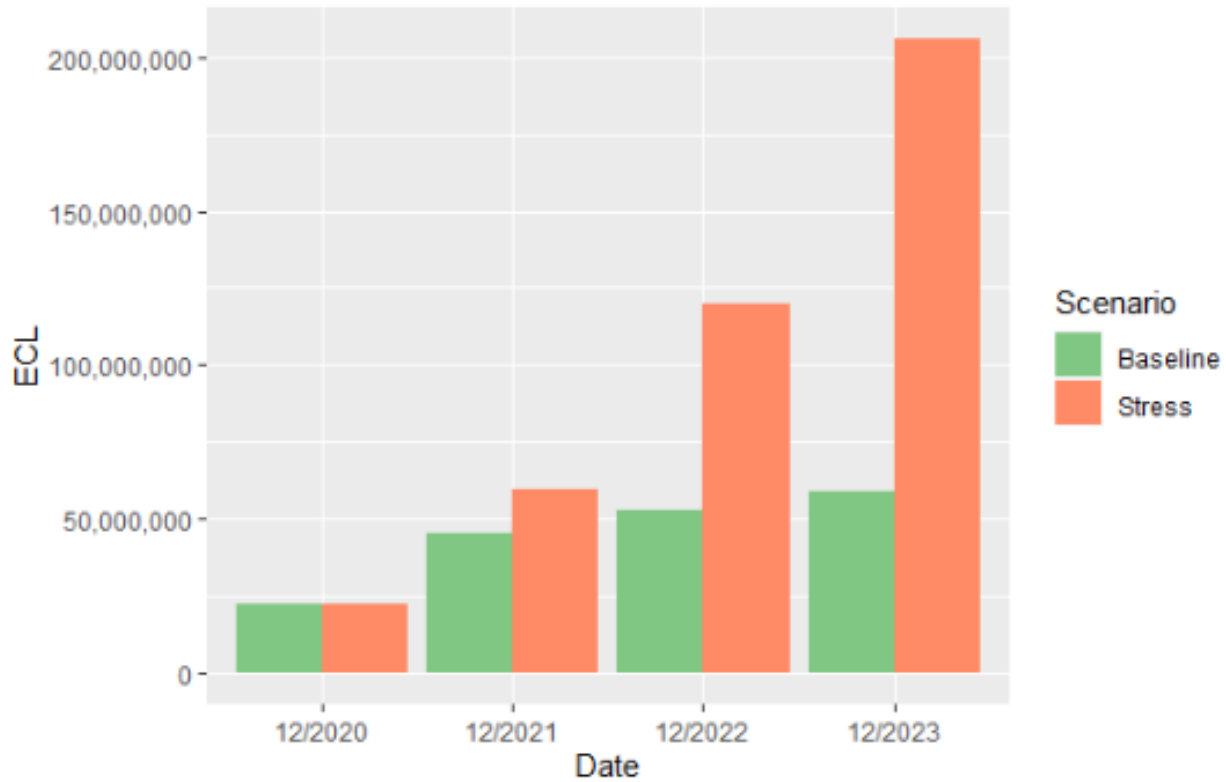
Summary – Dutch representative data example (using standardized RW calculations)

Scenario	Period	Accounts	Exposure	Provision	RWA	RW	RW Absolute Increase over Baseline
Baseline	Dec-20	818,653	€ 71,891,011,230	€ 22,017,425	€ 26,201,115,588	36.4%	
	Dec-21	818,653	€ 71,891,011,230	€ 45,541,098	€ 25,442,996,895	35.4%	
	Dec-22	818,653	€ 71,891,011,230	€ 52,579,525	€ 25,638,747,005	35.7%	
	Dec-23	818,653	€ 71,891,011,230	€ 58,660,632	€ 25,715,428,454	35.8%	
Stress	Dec-20	818,653	€ 71,891,011,230	€ 22,017,425	€ 26,201,115,588	36.4%	0.0%
	Dec-21	818,653	€ 71,891,011,230	€ 59,307,030	€ 26,392,259,688	36.7%	1.3%
	Dec-22	818,653	€ 71,891,011,230	€ 119,857,220	€ 29,593,665,081	41.2%	5.5%
	Dec-23	818,653	€ 71,891,011,230	€ 205,944,859	€ 32,032,194,947	44.6%	8.8%

Expected v Unexpected Losses

ECL & RWA

ECL by Scenario across a 3 year Forecast



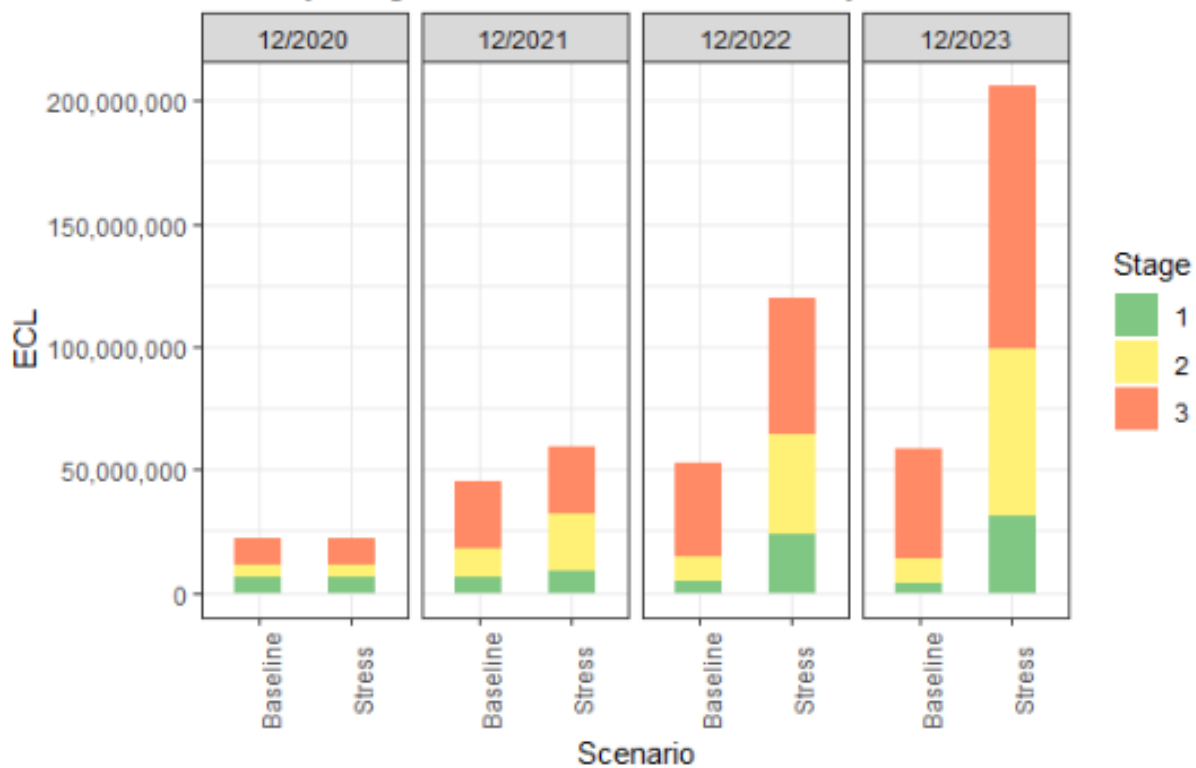
RWA by Scenario across a 3 year Forecast



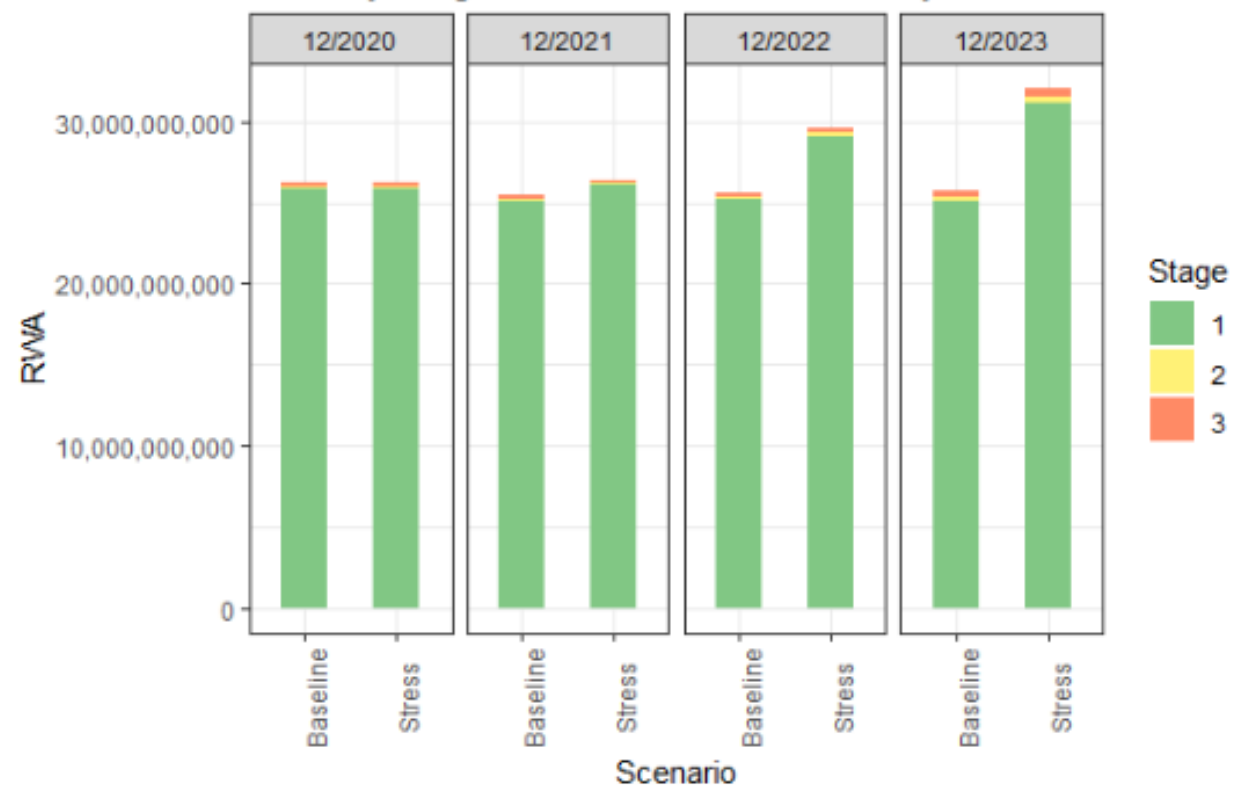
Expected v Unexpected Losses cont.

Forecasted Losses by IFRS9 Stage

ECL by Stage and Scenario across a 3 year Forecast



RWA by Stage and Scenario across a 3 year Forecast



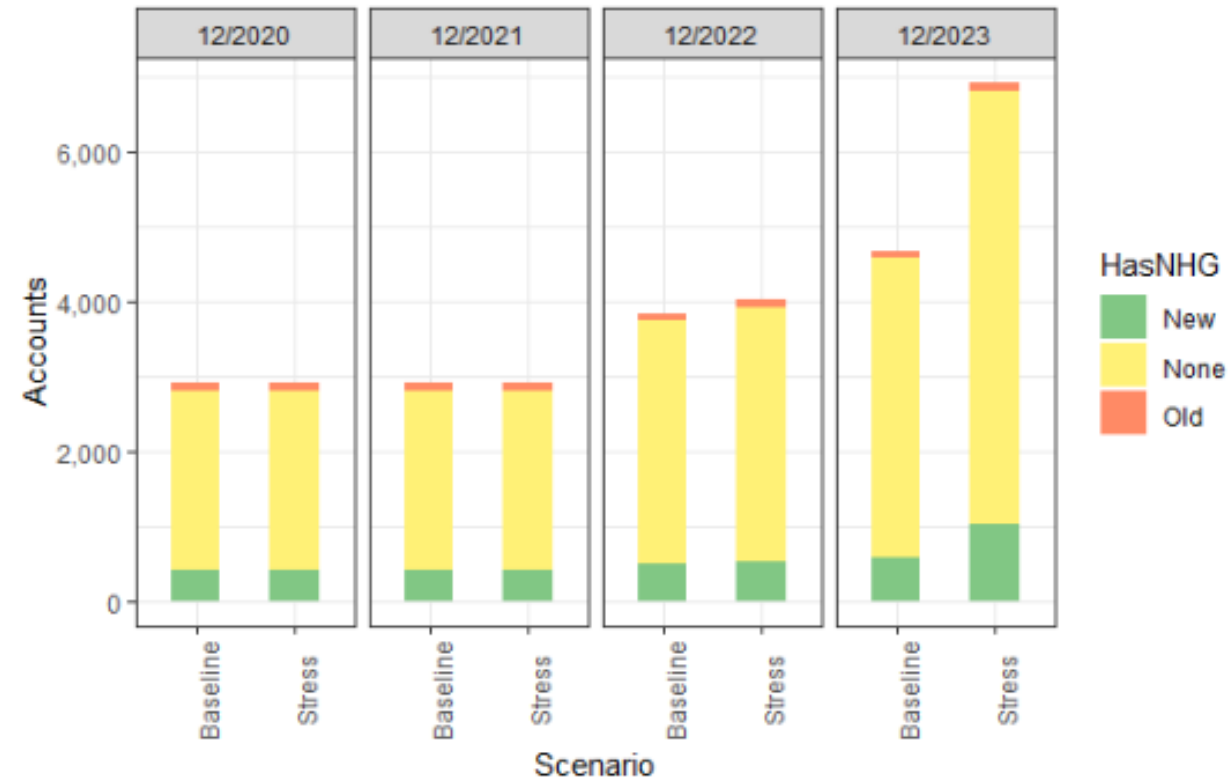
Forecasted Arrears

Arrears by Delinquency Status and NHG Indicator

Accounts in Arrears by Scenario across a 3 year Forecast



Accounts in Arrears by NHG Indicator and Scenario



Key Takeaways

1. The Dutch economy will need several years to recover from the pandemic, with the stressed scenario lasting towards a decade.
2. NHG Mortgages have greater LTV but still mostly assigned IFRS 9 Stage 1.
3. 12m PDs and 3yr conditional expected losses rise in the EBA stress scenarios.
4. Default risk increases in the EBA stress scenario but losses are contained for NHG mortgages.
5. While ECL rises under stress, the unexpected losses are similar across scenarios, resulting in a relatively smaller capital adjustment.

Q&A

Additional questions? Email us at help@economy.com

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Contact Us: Economics & Business Analytics Offices

West Chester, EBA-HQ

+1.610.235.5299

121 North Walnut Street, Suite 500
West Chester PA 19380
USA

New York, Corporate-HQ

+1.212.553.1653

7 World Trade Center, 14th Floor
250 Greenwich Street
New York, NY 10007
USA

London

+44.20.7772.5454

One Canada Square
Canary Wharf
London E14 5FA
United Kingdom

Toronto

+1.416.681.2133

200 Wellington Street West, 15th Floor
Toronto ON M5V 3C7
Canada

Prague

+420234747544

Pernerova 691/42
18600 Prague 8
Czech Republic

Sydney

+61.2.9270.8111

Level 10
1 O'Connell Street
Sydney, NSW, 2000
Australia

Singapore

+65.6511.4400

6 Shenton Way
#14-08 OUE Downtown 2
Singapore 068809

Shanghai

+86.21.6101.0172

Unit 2306, Citigroup Tower
33 Huayuanshiqiao Road
Pudong New Area, 200120
China

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