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Stress Tests and Asset Quality Reviews of Banks: a Policy Announcement Tool[☆]

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HIGHLIGHTS

- 2014 Comprehensive Assessment (CA) did not help to sort good from troubled banks
- CA results surprised the market revealing an unexpected harsher ECB policy stance.
- From CA results, the market understood the authority's main factors of concern.
- Due to CA, banks' regulatory costs and risks grew, increasing bank cost of equity.
- CAs give banking authorities a new announcement power to reach their targets.
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Abstract

It is common in the supervision of banks to perform and disclose a simultaneous standardized assessment of their asset quality, organizational effectiveness, strategic viability and resilience to financial turmoil. By investigating the European Central Bank 2014 Comprehensive Assessment and the stock reactions of the banks to its findings, we find that this process provides limited assistance to the market in sorting good from troubled banks. Notwithstanding, the market adjusts to these findings, since it understands that they signal the stance of supervisory policy toward banking activities, which begets the level of regulatory risk and cost for the supervised banks.

JEL Classification: G01, G14, G21, G28

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