Discussion paper

On the future changes to the EU-wide stress test
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<tr>
<td>CCAR</td>
<td>Comprehensive Capital Assessment and Review</td>
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<td>CET1</td>
<td>Common Equity Tier 1</td>
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<td>DFAST</td>
<td>Dodd-Frank Act stress test</td>
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<td>EBA</td>
<td>European Banking Authority</td>
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<td>ECA</td>
<td>European Court of Auditors</td>
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<td>ESRB</td>
<td>European Systemic Risk Board</td>
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<td>EU</td>
<td>European Union</td>
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<td>ICAAP</td>
<td>internal capital adequacy assessment process</td>
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<td>P2G</td>
<td>Pillar 2 guidance</td>
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<td>QA</td>
<td>quality assurance</td>
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<td>SREP</td>
<td>supervisory review and evaluation process</td>
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<tr>
<td>UK</td>
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Responding to this consultation

The European Banking Authority (EBA) invites comments on all of the proposals put forward in this paper and in particular on the specific questions summarised in Chapter 5. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which the comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/rationale proposed; and
- describe any alternative approach the EBA should consider.

Submission of responses

To submit your comments, click on the ‘send your comments’ button on the consultation page by 30 April 2020. Please note that comments submitted after this deadline or submitted via other means may not be processed.

Publication of responses

Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA’s rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA’s Board of Appeal and the European Ombudsman.

Data protection

The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EC) No 45/2001 of the European Parliament and of the Council of 18 December 2000 as implemented by the EBA in its implementing rules adopted by its Management Board. Further information on data protection can be found in the legal notice section of the EBA website.
1 Introduction

This chapter provides a short overview of the development of stress testing in the European Union (EU) over the past decade. It takes a short look at the current framework of the EU-wide stress test and the division of roles. The chapter also sets the boundaries of future development in line with the mandate of existing regulation and sets out the objective of the discussion paper.

1.1 Background

1. Since the global financial crisis, the stress test has become a widely used tool for supervisors to assess the resilience of banks and of the banking sector through its solvency. The first successful effort at using such tools was implemented by the United States Federal Reserve in 2009 in the Supervisory Capital Assessment Program. The success of that exercise led the Federal Reserve to use it on a permanent and regular basis. In Europe, supervisory solvency stress testing was first introduced by the Committee of European Banking Supervisors in 2009. The European Banking Authority (EBA) conducted its first EU-wide stress test in 2011. At that time, the EU banking sector was under pressure from the second-round effects of the global financial crisis as shown by the deterioration of some EU sovereigns.

2. The responsibility for carrying out the EU-wide stress test is mandated to the EBA by its founding Regulation, which gives the EBA powers (Article 32(2)) to initiate and coordinate the EU-wide stress tests, in cooperation with the European Systemic Risk Board (ESRB). This includes a responsibility for developing a common methodology (including its interpretation) and for the communication of outcomes (including the publication of results for each participating financial institution – Article 22(1a)). The ESRB designs the adverse macroeconomic scenario and the European Central Bank supplies the baseline macroeconomic scenario.

3. The EBA’s role reflects its legal mandate, as well as its governance and resources. The current setting provides the competent authorities with full responsibility for the quality assurance (QA) of the EU-wide stress test and for the decision on the follow-up supervisory actions.

4. Most of the features of the EU-wide stress test have remained unchanged since its establishment. It is a solvency stress test, based on a constrained bottom-up approach, conducted at the highest level of consolidation in the EU (group level) and applied to a sample that represents about 70% of EU banks’ total assets. In such an approach, banks’ projections – based on a hypothetical scenario provided – are subject to constraints and to a static

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balance-sheet assumption, meaning that their balance sheet is frozen at the reference date and that possible managerial actions for mitigating the impact of the shocks are not taken into account. The initial aim of having a bottom-up approach was to involve banks in the identification of risks through the use of their models and hence to foster banks’ development of efficient risk management practices. On the other hand, the exercise featured constraints, including a static balance-sheet assumption, to prevent banks from making overly optimistic projections and for assuring the consistency and comparability of results.

5. Another key feature of the EU-wide stress test has been the detailed disclosures, including bank-by-bank data on exposures and risk drivers. A comprehensive disclosure aimed to foster market discipline and so enhance public information on banks’ risk exposures. This was particularly evident during the exercises that were run between 2011 and 2014, which coincided with a relatively unstable economic environment. Such transparency provided a set of uniform, common and comparable data that could be used by market participants.

6. The 2011 and 2014 stress test exercises featured a hurdle capital rate, which determined whether a bank passed or failed the exercise and was used for identifying possible capital shortfalls and recapitalisation needs. After continuous capital-raising efforts in the EU banking sector since 2011, the average Common Equity Tier 1 (CET1) ratio increased to above 13% in 2015 and the crisis type of stress test appeared to be less relevant. The main transformation of the exercise came, therefore, in 2016. Instead of a ‘capital now’ approach, supervisors started using the results of the stress test to assess banks’ forward-looking capital planning and to determine possible capital needs. Stress test results are thus a key input for the supervisory review and evaluation process (SREP).

1.2 Discussing the potential changes

7. The EBA has, in the past, organised numerous workshops and other formal and informal interactions with stakeholders in order to improve the stress test methodology and processes. While such feedback was useful for deciding on the final stress test package in each exercise, there has never been a structured discussion on the post-crisis long-term strategy for the EU-wide stress test and on possible fundamental changes to the framework. The EBA has therefore decided to start assessing potential longer term changes to the EU-wide stress test approach.

8. The changes also aim to address some of the suggestions of the European Court of Auditors (ECA), which audited the 2018 EU-wide stress test and provided recommendations that might also require a redesign of the current framework. The ECA’s recommendations[4]

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focused on, among other things, the EBA’s resources, the division of roles, the QA of results, the methodology, the scenario design and the communication of findings and results.

9. The first formal step in assessing possible changes is this discussion paper, which will be followed by an assessment of the potential options. Nonetheless, if the final assessment shows that changing the current framework would bring very few benefits or would even reduce its current advantages, the EBA will keep the EU-wide stress test framework as it is.

1.3 Objectives and structure of the discussion paper

10. The purpose of the discussion paper is to present the EBA’s vision of the future of the EU-wide stress test and to collect comments and feedback from the different users of the stress test. While banks are key stakeholders of the stress test, feedback from other interested parties is essential and would greatly contribute to making a final decision on the most appropriate approach for the EU.

11. The basis of this discussion paper is a comprehensive stocktake of the lessons learnt from previous exercises, supervisory experience and stakeholders’ views. The feedback required in the consultation to this discussion paper should therefore contribute to the development of a framework that optimises its usefulness to supervisors, banks and policymakers, as well as its relevance to market participants.

12. The discussion paper covers, in Chapter 2, an assessment of the current EU-wide stress test framework, including its objectives and benefits, followed by the rationale for potential changes to the current framework. In Chapter 3, a possible new framework is suggested, including revised objectives for the EU-wide stress test, features of a new approach and the success criteria for such features. That chapter also looks at the interaction of the new framework with the scenario design and other risks. A roadmap that includes a high-level timeline is provided in Chapter 4. Finally, a summary of questions for discussion is provided at the end of the paper.
2 Assessment of the current framework

This chapter provides an assessment of the current setting and the features of the EU-wide stress test, with the framework’s current objectives serving as a starting point. Views have been collected through formal and informal interactions with all relevant stress test users, including competent authorities, banks, investors and academia. This chapter also sets out the rationale for possible changes to the framework.

2.1 Current objectives of the EU-wide stress test

13. The EU-wide stress test currently has a number of objectives that can be divided into four main categories.

14. Firstly, the exercise provides means for identifying the risks and vulnerabilities of EU banks and the EU banking system, including a contribution to the overall assessment of systemic risk in the EU financial sector. This includes not only identifying residual areas of uncertainties for single banks, but also singling out common patterns that could cause system-wide instability.

15. Secondly, the EU-wide stress test is part of the supervisory toolkit used by competent authorities to assess banks’ resilience to adverse market developments, to challenge banks’ capital position and to support the supervisory decision-making process with regard to the determination of Pillar 2 guidance (P2G) and appropriate mitigation actions.

16. Thirdly, the EU-wide stress test fosters banks’ own stress-testing and risk management capabilities.

17. Finally, the exercise aims to strengthen market discipline through the publication of consistent and granular data, on a bank-by-bank level, every 2 years.

2.2 Advantages of the current approach

18. One of the main achievements of the EU-wide stress test was its contribution to improving the EU banking sector’s resilience after the financial crisis. Some structural features of the exercise contributed decisively to that outcome. One of these features is the bottom-up approach. Unlike pure top-down supervisory approaches, a bottom-up approach involves banks in the process of projecting stressed results and therefore incentivises them to develop their risk management frameworks. Banks are often in the best position to assess their risks and to produce accurate projections. Maintaining a bottom-up approach was therefore beneficial, as it pushed banks to invest in and improve their risk models and allowed
supervisors to better understand the mechanics of banks’ internal models and projections in relation to their business models and risk profiles.

19. However, because the quality of projections provided by banks varies — some being overly optimistic and some not being robust enough — backstops and overrides were put in place in the form of constraints and supervisory QA. In some cases, they were also put in place to ensure comparability across banks.

20. Another benefit of the current approach is the fact that the process runs simultaneously across a large number of banks. The EU-wide stress test covers banks that represent around 70% of the assets in the EU banking system, which are tested against a common baseline and adverse scenario, as well as against a common methodology. The main benefit of undertaking stress tests in such a coordinated fashion is the production of consistent and comparable outcomes across banks in the EU. This is especially important for preserving a level playing field, as well as for identifying which banks are weaker and more sensitive to shocks.

21. Finally, the EU-wide stress test has been successful in increasing transparency across a wide sample of EU banks by disclosing granular information on a bank-by-bank basis. These data proved to be particularly useful during more uncertain economic periods, but also to be an important source of information for market participants and academia during calmer periods. According to the stakeholders’ views, the main benefits of having such disclosure are the continuity and consistency of data, as well as the possibility of comparing different banks.

2.3 Rationale for changes

22. Despite having a number of advantages, there are areas where the current framework could be improved and more fundamental changes might be needed.

23. The first area of concern is the lack of clarity and prioritisation of the EU-wide stress test objectives. At present, the exercise entails a number of objectives that are conflicting and difficult to fulfil in a single exercise. One example of such a conflict is the microprudential purpose of having the stress test results feeding each bank’s SREP concomitantly, which conflicts with the macroprudential objective of assessing systemic risks. Therefore, the redesign of the framework should be grounded on a clear definition of objectives, in particular whether the exercise aims to identify banks’ specific risks or system-wide risks in the EU banking sector. Such a decision might have an impact not only on the approach for projecting results, but also on the design of scenarios.

24. The second area of concern is the usage of results and their link to the supervisory process. The EU-wide stress test is less integrated in the regular supervisory process, especially in comparison with other international frameworks such as the ones in the United Kingdom (UK) and the United States (US). Some methodological constraints, such as the static balance-
sheet assumption, which does not consider management actions, make it difficult to convert the stress test capital depletion into a meaningful supervisory capital add-on (i.e. P2G) without further adjustments. The consideration of adjustments by supervisors leads to a lack of clarity regarding the link between stress test results and the P2G. Moreover, there is insufficient information on the implications of the stress test for other supervisory decisions, particularly with regard to capital distributions.

25. The third area of concern is the application of methodological constraints for some risks, even though the banks’ internal capabilities for projecting these risks might have improved. For that reason, reassessing the application of some of these constraints could be beneficial for improving the realism of stress test outcomes. Assuming a framework that is more integrated with the supervisory process, solutions should also be found for mitigating the limitations of the current static balance-sheet assumption. Nonetheless, it is important to consider that the implementation of such solutions without any counterbalancing measures could increase QA requirements and consequently the cost for both banks and supervisors.

26. The fourth area of concern is connected to the ownership of results. In the current approach, banks provide projections that can be overridden by the supervisory benchmarks and challenger models in the QA process. Even though banks are asked to confirm the figures before publication, they do not necessarily need to agree with them, and their consent does not constitute a legal requirement for the publication of bank-specific results by the EBA. Having a clear ownership of results would be beneficial for both parties.

27. The final concern is related to the resource-intensive nature of the exercise for all parties involved in conducting the EU-wide stress test, which is also related to the length of the process. The most resource-intensive part of the process is the design of the exercise (including the changes in the methodology and the selection and calibration of the scenario) and the QA of results, and there is a general agreement that the exercise should become more cost-efficient.
3 Proposed long-term changes to the EU-wide stress test framework

This chapter introduces proposals for possible changes to the EU-wide stress test framework, while trying to address the lessons learnt from previous exercises. The chapter starts by determining a clear objective of the stress test, which is followed by a list of success criteria for assessing different frameworks. The proposal is divided into possible changes to the general framework, the feasibility of introducing multiple scenarios and the possible consideration of other risks.

3.1 Proposed new framework

3.1.1 Objective of the EU-wide stress test

28. The new framework confirms that the EU-wide stress test is primarily a microprudential exercise whose main objectives are the assessment of banks’ capital adequacy and the identification of risks. For supervisors, the exercise is a concrete support for the SREP and for the assessment of capital planning. For banks, it should complement their internal capital adequacy assessment process (ICAAP) and contribute to improving their internal risk management practices.

29. An important by-product of the exercise is the dissemination of clear and comparable information to market participants on banks’ resilience and their ability to generate and distribute capital.

30. While the outcome from the EU-wide stress test can be used as an input in the assessment of systemic risks and the second-round effects of a crisis, the macroprudential role of the stress test is not considered one of its main objectives.

3.1.2 Success criteria

31. The changes to the EU-wide stress test are guided and assessed in terms of four criteria, namely the relevance, comparability, transparency and cost-efficiency of the exercise.

32. Relevance means that the stress test projections should be as close as possible to the actual impact on capital should an adverse scenario materialise. The stress test having relevance is also a prerequisite for enabling supervisors to identify vulnerabilities and for encouraging banks to enhance their own stress-testing capabilities to be used in their day-to-day management. Relevance requires, on the one hand, that the projections provide realistic estimates and, on the other hand, that they are reliable in spite of limited information, judgemental assumptions, model limitations and potential incentives for banks to deliver optimistic results. Relevance can a priori be increased by relaxing methodological constraints in the stress test methodology, thereby allowing banks, to a larger extent, to leverage on
own data and models, which may be better tailored to their individual business models, market environments and business practices. At the same time, methodological constraints act as safeguards to ensure the reliability of the projections. Achieving relevance in the stress test in practice thus requires trade-offs between realism and reliability.

33. **Comparability** means facilitating a level playing field across banks and jurisdictions in the EU, while still taking into account banks’ specificities and individual risk profiles. Comparability is fostered by methodological constraints, thorough supervisory QA and market discipline. A high degree of comparability is key to create a level playing field when the stress test results are used for supervisory purposes, especially the determination of P2G capital demand. Moreover, stress test results need to be comparable to provide a meaningful risk assessment when disclosed to the public.

34. **Transparency** allows markets and the wider public to gain information from the supervisory stress test. It also fosters market discipline by enabling market participants to review the stress test results of banks and the actions of supervisors. Transparency can also encompass providing information on the linkage between the stress test results and supervisory actions, particularly the P2G quantification. Different stakeholders may have different needs for transparency. Supervisors see value in the market discipline arising from transparency and in providing market participants with an assessment of banks’ resilience. Banks benefit from transparency by demonstrating their resilience and risk management capabilities to markets, investors and depositors. Other market participants and observers may use stress test results in their economic analyses and therefore appreciate the disclosure of detailed data and scenario projections. The priorities as regards transparency also depend on the economic environment. For instance, investors might be more interested in the resilience of banks in a crisis environment, while they might focus more on banks’ ability to distribute capital in a normal market environment.

35. **Cost-efficiency** means fulfilling the stress test objectives with commensurate resources from both supervisors and banks. In addition to the preparatory stage of the stress test (which includes, among other things, developing the scenario, methodology and QA tools), costs for supervisors depend on the length and level of detail of the QA process. In addition to QA, costs for banks also depend on the extent to which existing processes and models can be employed in the supervisory stress test. The length and granularity of the QA process, which affects both banks and supervisors, are in turn driven by, among other things, the targeted level of comparability, the existence of simplifying assumptions and the amount and detail of the data disclosed.

36. The different criteria can be at least partially competing. For instance, higher relevance and comparability of the stress test results require more supervisory QA, thereby increasing costs for banks and supervisors. Transparency can set incentives for ‘gaming’ by banks, thereby driving costs for QA in order to maintain the necessary levels of comparability and reliability in the results. Comparability can be increased by introducing methodological constraints and simplifying assumptions, which comes at the expense of relevance.
The challenge in designing the new stress test framework is therefore to find a preferable balance between the above criteria. This is guided by the aim to largely maintain the high levels of comparability and transparency established by the current EU-wide stress test while increasing its relevance and improving the overall cost-benefit ratio of the exercise.

### 3.1.3 Features of the framework

The proposed new framework of the EU-wide stress test is based on two legs: the supervisory leg and the bank leg. The supervisory leg would be a basis for supervisory decisions, directly linked to the P2G setting[^5], and a constrained approach. The bank leg would allow more flexibility and would focus on providing disclosure and fostering market discipline.

To assure a certain level of comparability between the two legs, both would use the same common scenarios and starting points for projecting the stress test results. A common methodology across jurisdictions and banks would be the basis for the supervisory leg, which would continue to be a constrained, bottom-up exercise. The level of prescriptiveness in that leg would be similar to the current methodology, even though the usage of certain constraints would need to be reassessed. In contrast, the methodology for the bank leg would be less prescriptive and would give banks more freedom in calculating their projections.

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[^5]: Competent authorities have the discretion to set P2G based on national stress tests and other risk assessment tools (see Box 4).
40. The two legs of the exercise would lead to two sets of outcomes: the supervisory outcome would be directly linked to the bank’s P2G and would provide limited disclosure, while the bank leg would facilitate market discipline through its broader transparency with granular disclosure.

Box 1: The alternative option of having a single stress test outcome would be resource-intensive

An alternative option to the disclosure of two results would be to have a framework with a single outcome resulting from a dialogue/synthesis and convergence between supervisors and banks. Even though such an option could reduce the communication challenges that arise when two different results are obtained, it would require a complex supervisory QA process for the bank leg and an increased number of interactions between competent authorities and banks. Therefore, it would not contribute to a more cost-efficient exercise for banks and competent authorities. This approach would also reduce the value added of the new framework in setting clear responsibilities for each leg and in fostering market discipline to the bank leg results.

41. The two legs are explained in more detail in the following subsections.

(i) Supervisory leg

42. The supervisory leg would be based on a constrained bottom-up approach similar to the current framework, whereby banks’ projections are challenged and quality is assured by supervisors using various challenger models and benchmarking tools.

43. For certain risks, the current framework already prescribes a more mechanistic approach, including the usage of benchmarks and formulas, which would also be possible under the new supervisory leg. Such an approach could be developed further by using a hybrid, whereby certain risk categories would remain in a constrained bottom-up fashion while others would be replaced by supervisory models relying more on top-down elements, hence requiring banks to deliver mainly starting points and possibly some historical information but no projections. Currently, the areas where such a top-down approach seems to be feasible in the nearer future are net interest income, credit risk, and net fee and commission income. A staggered approach might be considered, whereby these and possibly more top-down elements are phased in over time.

44. As part of the QA process, competent authorities can use all of the tools and information available, including the results of the bank leg, in order to arrive at the final supervisory view.
Box 2: Consideration of alternative approaches for obtaining the supervisory leg

In addition to the two options for deriving the supervisory leg outlined above, more extreme options such as a full top-down approach were also considered during the discussions.

In such an approach, modelling of bank-by-bank results would be left to supervisory top-down models, while banks would provide starting points. The approach would be very similar to the US Comprehensive Capital Assessment and Review (CCAR). While this approach would most likely reduce the costs for banks, it would also reduce their involvement in identifying risks. At this point, for some of the risks, such top-down models are robust enough. However, introducing a comprehensive tool covering all risk areas will not be possible in the near future; instead, it would be more of a long-term project. As more data are collected by supervisors and their models are further developed, such an approach might be considered beyond 2022.

Because this option does not seem to be feasible in the near future for various reasons (some of them mentioned above), it is not considered further in this discussion paper.

45. Supervisors would be the owners of the supervisory leg and would form their view on the capital impact of the scenario. Banks would not be required to sign off the results from the supervisory leg, and the overall QA interaction between banks and supervisors would be lighter, with potentially only two data submissions from the bank side and one iteration with supervisors. The publication of the supervisory leg would be limited to a basic set of data points focused on capital depletion and its main drivers.

46. Due to the ownership by the supervisor and the lighter QA interaction, as well as the potential usage of top-down features, the new framework could further deviate from the current approach in the following aspects:

- The static balance-sheet assumption could be relaxed in a controlled way by allowing the incorporation of certain actions implemented before the end of the QA phase and of certain actions planned and confirmed but not yet implemented before the end of the QA phase. An example would be the sale of a subsidiary that was confirmed after the start of the exercise.

- A limited set of methodological constraints could be relaxed compared with the 2020 EU-wide stress test methodology, but not to the same extent as could be the case for the bank leg. A list of some of the constraints included in the 2020 EU-wide stress test methodology is provided in Annex 1.6

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6 This list sets out the main constraints, but it should not be read as a suggestion of the constraints that need to be relaxed.
• The granularity of templates could be reduced, especially in connection with the potential top-down features.

47. The final outcome would be based on the supervisory leg projection. However, when forming the final outcome, the competent authorities could decide to consider projections coming from the bank leg. In any case, two results would be published, one result coming from the supervisory leg and another coming from the bank leg.

48. In cases where the supervisory leg would consider some bank leg components, the relevance of the exercise might be further improved because such an approach would take into account idiosyncrasies of the bank that are captured only in the bank leg. However, it would require more interactions between competent authorities and banks in order to identify areas where the supervisory leg result could be adjusted.

(ii) Bank leg

49. The bank leg would be obtained by using a flexible bottom-up approach. The methodology would be less prescriptive but still based on the same scenarios and templates that are common for all banks in order to have a comparable data set across banks. The results would not be quality assured by the supervisor, giving full ownership of the results to banks. Nonetheless, supervisors could conduct basic checks of starting point data that also serves as starting points for the supervisory leg and for which there is no discretion of banks to deviate in the two legs.

50. In the new framework, banks would use the same common methodology as in the supervisory leg for obtaining the bank leg, but they would be allowed to decide on whether to apply the constraints prescribed in this methodology or not. Practically, banks would be provided with a common methodology for the supervisory leg and a list of constraints that could be relaxed or disregarded. If the supervisory leg is partially obtained by supervisory top-down models (i.e. there is no common methodology regarding banks’ projections for the supervisory leg for these risk areas), methodological guidelines need to be introduced for these risk categories for obtaining the bank leg.

51. Banks could also decide to accept the outcome of the supervisory leg as their own and, in this case, be subject only to the QA process as described in the supervisory leg.

52. A possible option under consideration is to allow banks to use their ICAAP models for producing the bank leg results. With such an approach, they would still use a common scenario and common starting points, with only limited guidance and constraints to be applied in their projections. For example, banks would be provided with a list of management actions that they could consider when forming the projections in the bank leg. In addition, certain rather high-level assumptions could also be made for specific risk areas.
Regardless of the degree of relaxation of the methodological constraints, the reporting to the competent authorities and the EBA would be based on common templates.

Questions

Question 1: What are your views on the proposed framework in general?

Question 2: What are your views on determining the supervisory leg (a constrained bottom-up approach such as the current approach or a hybrid approach with top-down models replacing some bottom-up elements)?

Question 3: What are your views on determining the bank leg (a prescribed methodology with the possibility of relaxing constraints)? What are your views on the possibility to use ICAAP as the basis for the bank leg? What are the areas where ICAAP would not be suitable for this purpose?

Question 4: What are your views on the alternative proposal to publish one single CET1 capital depletion which would result from a dialogue/synthesis between the competent authority and banks?

Question 5: What are your views on the consideration of the bank leg outcome in forming the final supervisory outcome?

Question 6: What are the costs of the new proposed framework and where do they come from? What are the benefits? How can the bank leg and supervisory leg be structured to mitigate costs and increase benefits?

Question 7: Which constraints should be relaxed to improve realism (some of the constraints are listed in Annex 1)? Please rank the constraints by their importance in improving realism.

Question 8: For generating the bank leg, would you prefer that banks have a discretion to relax certain methodological constraints or have a common methodology that would be less constrained than the one in the supervisory leg?

Question 9: How different is the ICAAP approach from the supervisory leg (assuming the methodology is the same as in the current framework) if all constraints are dropped?

Question 10: Would banks benefit from setting some assumptions for specific risks and giving general guidance, even if they are allowed to use their own models without constraints?

Question 11: What are the benefits of the bank leg and how would you increase them?

Question 12: What are your views on the possibility of having limited supervisory QA to the bank leg?
Question 13: Which dynamic effects do you find are important to consider?

3.1.4 Communication of stress test results and disclosure

54. In the framework described above, two different stress test results would be obtained, reflecting the supervisory leg and the bank leg. Both results would be disclosed to increase the relevance of the stress test exercise. The idiosyncratic features of banks could be incorporated in the results of the bank leg, while the supervisory leg would provide results that, by virtue of a horizontal review, are more comparable.

55. The EBA would disclose, bank by bank and on aggregate, the results derived from the supervisory leg. These disclosures would be limited to the capital ratios relevant to capital distribution and key drivers for each scenario.

56. The EBA would disclose, bank by bank, granular data based on the bank leg. The disclosure of granular data from the bank leg would be based on common disclosure templates similar to the EBA transparency templates of the 2020 EU-wide stress test. The level of transparency should be at least as exhaustive as in the current setting, but the content might be reviewed if deemed necessary to increase market discipline and the relevance of the information for stakeholders. Such disclosure should allow stakeholders to exert market discipline on the banks’ views of their risks, starting point data and projected financial position under adverse conditions.

57. In line with paragraph 51, the granular data disclosed could be based on the bottom-up information reported in the supervisory leg if a bank considered that this information reflected its business model and risk profile.

58. Box 3 compares the envisaged disclosures in the EU-wide stress test with the current disclosures in the US and the UK.

Box 3: Current disclosures in the US and the UK and the envisaged disclosures in the EU-wide stress test

This box compares the disclosures in the US CCAR, the US Dodd-Frank Act stress test (DFAST) exercises, the UK stress test and the proposal for the EU-wide stress test.

In both the US and UK frameworks, the disclosures are less granular than in the proposed EU framework and are focused mainly on capital depletion. The aim of providing more transparency in the EU-wide stress test than in the US and UK is to foster increased market discipline, which would also address the general lower disclosure of bank data in Europe and limit the incentives for banks to provide overly optimistic projections.
The disclosure of granular data would keep the transparency of the exercise and the possibility for stakeholders to benchmark banks’ starting points and projections at similar levels to the current ones. Having this granularity based on the bank leg would increase the relevance of transparency, as it would incorporate banks’ idiosyncratic features that might not be fully
captured in the supervisory leg due to the application of constraints. Moreover, banks would also be able to better explain and communicate their results.

59. Since two different results would be disclosed, one derived from the supervisory leg and another from the bank leg, an explanation of the differences between the two would have to be provided. Banks would need to quantify and disclose the standalone impacts of each component that drive the differences between the CET1 capital depletion in the bank leg and in the supervisory leg, except for the changes that are due to supervisory adjustments. The following non-exhaustive list provides some aspects that are expected to lead to differences in the bank leg, especially in a framework where ICAAP plays a relevant role: (i) the removal of methodological constraints (e.g. caps and floors), (ii) dynamic versus static balance sheets (e.g. lending increase), (iii) the inclusion of management actions (e.g. additional Tier 1 coupon distribution) and (iv) additional risks considered.

60. In line with the EBA SREP guidelines,\textsuperscript{7} the stress test results are an important component of the determination of the P2G. The disclosure of stress test results should therefore provide enhanced clarity on the supervisory expectation for the capital needs of each bank. In the new framework, the starting point to be considered by competent authorities in the determination of P2G should be the CET1 capital depletion from the supervisory leg.\textsuperscript{8}

61. There are three possibilities under consideration for the disclosure of the supervisory expectation of banks’ capital needs: (i) disclosing the final P2G, (ii) disclosing ranges of P2G values and allocating banks to the buckets in accordance with their final P2G or (iii) disclosing not P2G but the CET1 capital depletion net of any adjustments applied by competent authorities so that the published stress test results are in line with the final P2G and are informative in terms of supervisory expectations regarding capital distribution. These final adjustments are typically related to material and irreversible measures taken during the year that affect the bank’s capital position (e.g. capital measures) or other risks that might not be fully reflected in the methodology and scenario.

Box 4: Disclosure of supervisory usage of the EU-wide stress test results and the expectation of banks’ capital needs

Competent authorities have the discretion to set P2G based on national stress tests and other risk assessment tools. In fact, some competent authorities use the EU-wide stress test not as the main supervisory exercise but rather as a component of a wider suite of stress tests and

\textsuperscript{7} EBA/GL/2014/13. The EBA published a roadmap on 21 November 2019 (Risk Reduction Package roadmaps) outlining its plans to revise the common European framework for the SREP. This revision may also cover P2G features, including its determination and disclosure options, which are relevant to the stress-testing framework.

\textsuperscript{8} Competent authorities have the discretion to set P2G based on national stress tests and other risk assessment tools (see Box 4).
benchmarking tools. In such cases, the link between the outcome of the EU-wide stress test and P2G is less direct, and competent authorities would explain how the EU-wide stress results were considered in the supervisory process. Regardless of the approach followed, competent authorities should be able to provide enough information on their expectations on distribution of capital as the result of their assessment.

62. Banks would also have the opportunity, if deemed relevant, to publicly communicate the planned management mitigation actions to restore the capital position in an adverse scenario and their capacity to distribute capital.

Questions

Question 14: What are your views on the proposed granularity of disclosures? Is the granularity appropriate and does it contribute to an improved quality of banks’ stress test deliverables and practices?

Question 15: What are your views on the disclosure of granular information based on the bank leg? Do you think that the bank view is the best option for providing transparency to the markets?

Question 16: What are your views on a limited disclosure of the supervisory leg, mainly focused on the capital depletion from the stress test results? Do you see challenges in maintaining the overall comparability across banks?

Question 17: How could the current transparency templates of the EU-wide stress test be improved? Please specify in detail what information should be included in or excluded from the transparency templates.

Question 18: Is the granularity of the transparency on exposures and credit risk impairment deemed useful for market discipline? What are the potential drawbacks of such a granular disclosure?

Question 19: What are your views on the proposed publication of two different CET1 capital depletions (i.e. the bank leg and supervisory leg)? How would you interpret two different outcomes?

Question 20: What are your views on the disclosure of the bank leg knowing that the supervisory involvement would be limited to basic data checks of the starting points?

Question 21: What would the challenges be in explaining differences between the bank leg and the supervisory leg? Are there limitations for the computation of the standalone impact of each driver of differences (e.g. from the removal of each constraint in the bank leg)?
Question 22: What are your views on a possible disclosure of the differences between the bank leg and the supervisory leg? What level of detail of such a disclosure would you consider appropriate?

Question 23: Do you identify benefits in following any of the three possibilities for a disclosure of stress test results that is more aligned with the final P2G?

Question 24: Do you know of any drawbacks of publishing the banks’ final P2G?

Question 25: What is your view on the public communication by banks of their management actions to restore the capital position and their capacity to distribute dividends?

3.1.5 Assessing success criteria

In this section, the proposed new framework for the EU-wide stress test is evaluated against the assessment criteria set out in Section 3.1.2, namely the relevance, comparability, transparency and cost-efficiency of the exercise. The criteria are assessed against the existing EU-wide stress test framework. This section also discusses potential risks.

The relevance of the stress test for banks and supervisors is increased under the new framework.

The bank leg increases the relevance of the exercise for banks’ own risk management because the possibility of deviating in the bank leg from methodological constraints would allow banks to leverage more on their own models. In the more bespoke methodology, banks could better reflect specificities of their portfolios and exposures, thereby focusing on their idiosyncratic risks (provided that these results remain sufficiently reliable).

The supervisory leg increases the relevance of the stress test for supervisors. Like in the bank leg, the controlled relaxation of some methodological constraints will make the results more realistic than in the existing framework. On the other hand, the supervisory leg assures the reliability of the projections by using a combination of a constrained bottom-up approach, potential top-down features and supervisory QA.

The overall relevance of results would also be achieved by establishing a clear ownership of results. The bank leg would be owned by banks, which would decide how to model the projections, while the supervisory leg would be fully owned by the supervisors, reflecting their view without a need to be signed off by banks.

The comparability of stress test results in the new framework would evolve separately for the bank and supervisory legs.

In the bank leg, the comparability of stress test results would be reduced in comparison with the current approach. In general, the bank leg results will not be directly comparable because
banks may make stronger use of own models and could deviate from constraints in the common methodology to different extents. In addition, the absence of supervisory QA on the bank leg stress test projections, apart from basic data checks of the starting points, will make these results less comparable. The lower comparability would, however, be mitigated by the requirement from the banks’ side to disclose information on their deviation from the constrained bottom-up approach, explaining which constraints they have relaxed. This would be reported in a standardised format, which analysts could use to investigate differences in banks’ results.

70. The comparability of the supervisor leg results will remain high due to the presence of methodological constraints and to the consistent application of supervisory models. A high comparability of the supervisory leg results is key to ensuring a level playing field when disseminating the results to the public and using them for the determination of P2G.

71. Transparency would, overall, remain at the level established by the existing EU-wide stress test, or would even slightly increase. As outlined above, it is assessed separately, from the perspectives of supervisors, banks and other market participants.

72. The detailed disclosure of the bank leg results will provide a similar amount of information about banks’ projections and their starting point balance sheets as the current exercise. Supervisors will benefit from leveraging on market discipline when the banks’ results are reviewed by analysts and academics. Banks can demonstrate their individual financial resilience and their stress-testing capabilities to the public. Market participants and analysts will continue being supplied with detailed starting point and projection data for each participating bank. The standardised disclosure of deviations from the common methodology will provide analysts with insights into banks’ individual risk management capabilities. This in turn can contribute to the further development of best-practice stress-testing approaches in the industry.

73. The amount of information disclosed from the supervisory leg will be significantly lower than that disclosed from the current EU-wide stress test. From the perspective of the supervisors, the less detailed disclosure is a key enabler of making the execution of the stress test more efficient through the possibility of directly adjusting the bank-level results, thereby significantly reducing the effort of communication with the banks. As a consequence, banks will have fewer insights into the results of the supervisory leg and will perceive it as less transparent than the current set-up. Other market participants will also be provided with a significantly lower quantity of information from the supervisory results. However, the relevance of the information might be higher because the disclosed information on the link between the stress test results and the supervisory actions derived from it – such as P2G – could give investors new insights into the resilience of the banks and their ability to distribute capital. A publication that provides enhanced clarity on banks’ final capital needs would increase the relevance and transparency of the stress test exercise. Such a disclosure should be useful for ranking banks according to their sensitivity to an adverse scenario and should also provide valuable information on banks’ capacity to distribute dividends.
74. **Cost-efficiency** would, overall, be increased under the proposed framework, although the way this materialises, and to what extent, is different for the various stakeholders and will also depend on their individual approaches to the stress test. However, it is emphasised that banks would have to produce two sets of results, one for the bank leg and one as an input into the supervisory leg.

75. Providing an additional set of results for the bank leg will require extra efforts from banks compared with the existing approach. However, it would be somewhat reduced due to a lighter QA process and fewer iterations with the supervisors in the supervisory leg. In addition, the incremental costs required for this are, to a large extent, under the control of the banks. Banks may also reap synergies from investing in models that can be used for both internal risk management purposes and the supervisory stress test. Furthermore, banks have the possibility of minimising the incremental costs by not deviating from constraints of the common methodology for the supervisory leg, thereby reusing their input for the latter for their bank leg results. Banks will need to anticipate costs arising from communication efforts related to the publication of their results, such as organising press conferences or responding to enquiries by analysts and investors. For supervisors, it is key that no QA process needs to be conducted on the bank leg projections, except for basic data checks of the starting points, so that the creation of the bank view is cost-neutral for them.

76. The design of the supervisory leg is meant to improve the cost-benefit balance for both supervisors and banks by reducing the level of detail in the QA that was previously needed because of the granular public disclosure. The less detailed disclosure combined with the full ownership of the supervisory leg will enable supervisors to conduct their QA at a less granular level and to adjust the initial projections by banks directly without banks’ consent. Therefore, the efforts required to communicate and agree with banks on the implementation of requested changes are reduced. The freed-up supervisory resources could be invested in areas where constraints are relaxed. At the same time, banks will also need to engage in less interaction with supervisors during the stress test, which will reduce banks’ costs related to the supervisory leg compared with the current framework.

77. In addition to the assessment of criteria, Box 5 summarises the potential risks that may arise with the introduction of the proposed stress test framework.

**Box 5: Risks attached to the new stress-testing framework**

The following possible risks need to be considered when assessing the proposed new stress-testing framework:

- Given that the bank leg results are not quality assured by supervisors, other than basic data checks of the starting points, the relevance of the bank leg relies entirely on the reliability of the banks’ own results. The latter, in turn, depends on the quality of the banks’ data and stress test models, as well as their incentives to provide a faithful picture.
of their risk profiles. Therefore, the envisaged level of relevance of the bank leg may not be achieved if the results published by banks are not sufficiently scrutinised by the markets to enforce market discipline.

- With less intense interaction with banks during the QA process in the supervisory leg, some potential distortions or errors might not be discovered in the projections submitted by banks for this leg.

- A bank could materially deviate in its bank leg results from the supervisory leg outcome in a way that is not transparent to the markets, triggering an intense discussion on which of the two outcomes is more ‘realistic’. A bank could, for example, argue in this context that it cannot explain the delta between the bank and supervisory legs because the latter is not transparent to them (‘supervisory black box’). This could be mitigated if the methodology behind the challenger models to generate the supervisory leg is disclosed.

- Banks might challenge the supervisory leg results because they do not have to consent to the results any more.

- It is to be expected that communication challenges will arise from the publication of two sets of results. Stakeholders might not fully understand the source of differences between both results. This drawback can be exacerbated if stakeholders deem it important to have a reconciliation and banks are unable to quantify the impact of each driver of differences not explained by the supervisory QA (e.g. derived from the removal of constraints in the bank leg). Banks could also publish their initial input into the supervisory leg as a third set of results. These challenges will, however, be mitigated by the facts that:
  
  i. the target audience is aware that the bank leg is based on a different (i.e. less constrained) methodology than the supervisory leg, which implies that different outcomes are to be expected;

  ii. the supervisory leg is disclosed only at a high level, which rules out a detailed comparison of results similar to the much more granular bank leg;

  iii. supervisors would provide every bank with information about its supervisory leg outcome sufficiently in advance of the public disclosure, which may help to rein in divergent outcomes between the two legs.

- The proposal may not achieve the expected efficiency gains from the less intense interaction between banks and competent authorities during the generation of the supervisory leg. This could, for instance, occur because the two sides still engage in intense discussion due to the relevance of the supervisory leg results to the P2G and the public disclosure (the ‘beauty contest’ challenge remains). It could also still happen that clarifications to the common methodology necessitate resubmissions by banks after they have provided their initial inputs into the supervisory leg.
• The resources and time dedicated by banks to develop the bank leg, as well as by the markets to understand and challenge those results, may be reduced if the contribution of the bank leg to the final P2G is deemed insufficient.

Questions

Question 26: Does the proposed framework fulfil the assessed criteria better than the current framework?

Question 27: Please provide your assessment of the criteria for the new framework in the matrix below, explaining, for each leg, how it fulfils the criteria, followed by an overall assessment of the new framework. Please assess the new framework against the current one, indicating firstly if the criterion increased, decreased or stayed the same, followed by an explanation.

<table>
<thead>
<tr>
<th></th>
<th>Bank leg</th>
<th>Supervisory leg</th>
<th>Overall exercise</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relevance</td>
<td></td>
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<tr>
<td>Comparability</td>
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<td>Transparency</td>
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<tr>
<td>Cost-efficiency</td>
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3.2 Feasibility of introducing changes to the scenarios’ design

Scenario design is one of the key elements of the stress-testing framework. The current framework includes a baseline and an adverse macroeconomic scenario: the former has a relatively high probability of occurrence, while the latter is less likely to unfold at a time of economic distress. The common adverse scenario assumes a narrative (trigger), which usually comes in the form of an external shock, causing negative implications for macroeconomic variables in each EU country, as well as globally. Nonetheless, for assessing banks’ resilience to various types of shocks or identifying all of the possible risks they are facing, testing them against a range of scenarios would be more desirable. This is not least because, in the heterogeneous EU, each country is affected differently by the external shock, causing cross-country variation in shock severity, but also because differences in banks’
business models imply that scenarios that might be relevant to some banks might be much less relevant to others. To make the framework more useful for identifying risks and for exploring a wider number of vulnerabilities, this discussion paper looks at the possibilities of introducing multiple scenarios, sensitivity analyses or exploratory scenarios.

3.2.1 Multiple scenarios

There are two main elements of a scenario design: the first is the severity and the second is narrative. While the first is essential for determining banks’ overall resilience, the second is important for identifying risks. Testing banks against a number of scenarios with different severities and various narrative paths would be ideal; however, with the different options on reconciling the outcomes of the new framework, such an approach might significantly increase costs. Therefore, until a more complete top-down framework is developed, the proposal of multiple scenarios is limited to two adverse scenarios.

One option could resemble the scenario design in existing stress tests, such as the one conducted by the Federal Reserve. Such an approach would use two common adverse stress scenarios: one that aims for a broadly constant degree of severity across stress tests in different years, independent of economic and financial conditions, and another, usually increasing in severity in an upwards cycle, that seeks to take into account prevailing conditions when calibrating scenario severity, including the levels of leverage, debt and credit growth. This would provide valuable input for identifying risks and banks’ resilience in the current conditions, as well as information on whether resilience has improved compared with previous years.

Another option would be to introduce asymmetric scenarios, where both scenarios would take into account prevailing conditions but would follow different, possibly opposite, narratives, with comparable severity. For example, one narrative would be an inversion of swap rate curves anticipating a prolonged period of low growth in the EU, while the second would generate an abrupt repricing of risk premia in global financial markets. With these two scenarios, the stress test would explore a wider range of banks’ potential vulnerabilities, but the results would be less comparable across years.

The proposal of multiple scenarios has, however, three main challenges. Firstly, there would be difficulty in communicating results, because there would be more than one. When deciding on the communication approach, both the scenario design option and the reconciliation approach of the new framework would have to be considered. Secondly, producing projections of two scenarios would increase the costs of the exercise, especially if the projections for both scenarios would have to be quality assured. Finally, having two scenarios with a plausible combination of relevant risks would still leave some banks with

very little effect in their projections and therefore would not be particularly relevant to understanding their vulnerabilities.

3.2.2 Sensitivity analyses

83. Another possibility is to keep one comprehensive macroeconomic scenario, which, although it might vary in its narrative over time, would include additional sensitivity analyses. In this way, supervisors would be equipped with a broader view on banks’ vulnerabilities, although this would be based on more stylised assumptions and would take bank specificities into account to a somewhat smaller degree. These sensitivity analyses could provide valuable insight by looking at the risks that unfolded in some of the historical episodes (e.g. liquidity risk, sovereign risk, real estate bubbles or emerging markets stress) or by taking a more forward-looking view and assessing banks’ sensitivities to, for instance, climate change, business model disruptions or negative rates. Such sensitivity analyses would be implemented on top of the comprehensive macroeconomic scenario. The cost associated with these additional sensitivity analyses would depend on the design.

3.2.3 Exploratory scenarios

84. Some features of the new framework could also be used for introducing exploratory scenarios, which would focus on potential risks with very short realisations (e.g. liquidity risk) or on risks coming from longer term changes in the business environment (environmental, social and political) or in technology, or even risks from structural changes. Such risks would include any relevant and emerging threat to banks in the foreseeable future, such as the risk of climate changes or cyber-attacks. However, some of these risks usually require less conventional features, including the introduction of a horizon that would be shorter or longer than 3 years and the consideration of a much higher level of dynamism in balance-sheet evolution. In the exploratory scenarios, the focus would shift from determining capital depletions and solvency levels to assessing business continuity or longer term strategies.

85. A good example of a risk that could be tested as part of the exploratory scenario and is not necessarily connected to banks’ solvency is liquidity risk. The liquidity stress test could be performed in combination with the solvency stress test or as a separate exercise.

86. Exploratory scenarios could also be used for assessing system-wide reliance across sectors. Such a cross-sectoral stress test would include not only banks, but also insurance companies, pension funds, other financial institutions and perhaps very large corporates at the same time.

87. The potential new features outlined above might be included as standalone exercises or via a fully fledged EU-wide stress test. Even though the two-legged approach could be used for testing various risks in the exploratory scenario, some features would have to be adjusted, possibly through the design of the methodology. In any case, a future methodology should not limit stakeholders when extending the scope of risks covered or limit how these risks will
be included. In other words, the methodology should serve as an unbiased framework that allows future developments to be incorporated.

**Questions**

Question 28: What are your views on the consideration of two common adverse scenarios?

Question 29: What are your views on the consideration of two asymmetric adverse scenarios?

Question 30: What are your views on the use of sensitivity analyses to complement a single adverse scenario?

Question 31: What are your views on the use of exploratory scenarios to address risks in a longer term perspective?
4 Roadmap

This chapter introduces a roadmap for the implementation of changes to the current framework, including a high-level timeline and the process for the public discussion on the possible changes.

88. The new proposed framework would be introduced in the 2022 EU-wide stress test at the earliest. However, it depends on the specific approaches that are chosen, in particular the approaches connected to the design of the bank leg, the reconciliation of the two legs and the level of incorporation of top-down elements in the supervisory leg.

89. The new framework might need to be implemented in several stages. In particular, this would apply if top-down elements were included in the supervisory leg. This roadmap does not discuss the stages of potentially introducing top-down elements.

90. Under a scenario in which the new framework is rolled out in the 2022 EU-wide stress test, the methodology for this exercise would have to be approved during the last quarter of 2021. For meeting this deadline and leaving enough time for designing the methodology and consulting the public on it, the decision on the changes to the framework would have to be approved by the end of the third quarter of 2020.

91. Taking into account the assumed roadmap of introducing the new framework, the consultation of this discussion paper with the public will last until the end of April 2020. A public hearing will be organised in February. This will be followed by a potential revision of the framework, with the consideration of comments and suggestions that are received from the public. Around mid-June, the EBA will provide feedback on the comments received, summarising how they will be considered in the final new framework. The EBA Board of Supervisors will be consulted on the revised proposal before the final approval by the end of the third quarter of 2020. The final decision is expected to be communicated by October 2020, which would be followed by ordinary preparatory work, following the same timelines as for the 2020 exercise.
### Table 1: High-level timeline for the implementation of the new framework

<table>
<thead>
<tr>
<th>Description</th>
<th>Milestones</th>
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<tbody>
<tr>
<td>Publish the discussion paper</td>
<td>End of January 2020</td>
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<tr>
<td>Consultation and results</td>
<td></td>
</tr>
<tr>
<td>Industry consultation</td>
<td>End of January 2020 to April 2020</td>
</tr>
<tr>
<td>Public hearing on the discussion paper</td>
<td>February 2020</td>
</tr>
<tr>
<td>Feedback to the industry on the comments and suggestions</td>
<td>Mid-June 2020</td>
</tr>
<tr>
<td>The final EBA decision on the changes</td>
<td>Mid-September 2020</td>
</tr>
<tr>
<td>Communicate changes</td>
<td>October 2020</td>
</tr>
<tr>
<td>Develop the new methodology</td>
<td>2021</td>
</tr>
</tbody>
</table>
## 5 Summary of the questions for stakeholders

### Proposed long-term changes to the EU-wide stress test framework

#### Proposed new framework

<table>
<thead>
<tr>
<th>Question 1</th>
<th>What are your views on the proposed framework in general?</th>
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</thead>
<tbody>
<tr>
<td>Question 2</td>
<td>What are your views on determining the supervisory leg (a constrained bottom-up approach such as the current approach or a hybrid approach with top-down models replacing some bottom-up elements)?</td>
</tr>
<tr>
<td>Question 3</td>
<td>What are your views on determining the bank leg (a prescribed methodology with the possibility of relaxing constraints)? What are your views on the possibility to use ICAAP as the basis for the bank leg? What are the areas where ICAAP would not be suitable for this purpose?</td>
</tr>
<tr>
<td>Question 4</td>
<td>What are your views on the alternative proposal to publish one single CET1 capital depletion which would result from a dialogue/synthesis between the competent authority and banks?</td>
</tr>
<tr>
<td>Question 5</td>
<td>What are your views on the consideration of the bank leg outcome in forming the final supervisory outcome?</td>
</tr>
<tr>
<td>Question 6</td>
<td>What are the costs of the new proposed framework and where do they come from? What are the benefits? How can the bank leg and supervisory leg be structured to mitigate costs and increase benefits?</td>
</tr>
<tr>
<td>Question 7</td>
<td>Which constraints should be relaxed to improve realism (some of the constraints are listed in Annex 1)? Please rank the constraints by their importance in improving realism.</td>
</tr>
<tr>
<td>Question 8</td>
<td>For generating the bank leg, would you prefer that banks have a discretion to relax certain methodological constraints or have a common methodology that would be less constrained than the one in the supervisory leg?</td>
</tr>
<tr>
<td>Question 9</td>
<td>How different is the ICAAP approach from the supervisory leg (assuming the methodology is the same as in the current framework) if all constraints are dropped?</td>
</tr>
</tbody>
</table>
**Question 10:** Would banks benefit from setting some assumptions for specific risks and giving general guidance, even if they are allowed to use their own models without constraints?

**Question 11:** What are the benefits of the bank leg and how would you increase them?

**Question 12:** What are your views on the possibility of having limited supervisory QA to the bank leg?

**Question 13:** Which dynamic effects do you find are important to consider?

**Communication of stress test results and disclosure**

**Question 14:** What are your views on the proposed granularity of disclosures? Is the granularity appropriate and does it contribute to an improved quality of banks’ stress test deliverables and practices?

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Assessing success criteria

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Feasibility of introducing changes to the scenarios’ design

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Question 30: What are your views on the use of sensitivity analyses to complement a single adverse scenario?
Question 31: What are your views on the use of exploratory scenarios to address risks in a longer term perspective?
Annex

Annex 1: List of some constraints in the 2020 EU-wide stress test

Table 2 lists some of the constraints of the 2020 EU-wide stress test methodology, given in the order in which they appear in the EBA 2020 methodological note (without prejudice to the importance of their potential impacts on the banks’ results). The list does not provide any suggestion of relaxation, as that decision will be based on further analyses and the feedback received.

Table 2: Main constraints in the 2020 EU-wide stress test

<table>
<thead>
<tr>
<th>Constraint</th>
<th>Paragraph number in the methodological note</th>
</tr>
</thead>
<tbody>
<tr>
<td>No cures from stage 3 assets (i.e. no transitions from stage 3 to stage 2 or stage 1)</td>
<td>34</td>
</tr>
<tr>
<td>Significant increase in credit risk backstop</td>
<td>57</td>
</tr>
<tr>
<td>No negative impairments permitted for stage 3</td>
<td>143</td>
</tr>
<tr>
<td>Prescribed increase for securitisations and risk-exposure amount for securitisations floored separately for aggregate standardised and internal ratings based portfolios</td>
<td>186</td>
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period; the average is multiplied by 0.8 under the baseline scenario and by 1.5 under the adverse scenario

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