
1 July 2016

Information update on the 2016 EU-wide stress test

Using the 2016 EU-wide stress test results in the SREP process

1. This information update explains how supervisors intend to use the stress test results in the supervisory review and evaluation process (SREP). This update serves as a general guide to manage expectations on behalf of banks and market participants but does not establish restrictions or constraints on any existing supervisory powers.
2. The focus of the update is on the employment of capital guidance to cover potential shortfalls in own funds based on the outcomes of supervisory stress tests. Although capital guidance does not constitute any form of minimum capital requirement, institutions are expected to incorporate it in their risk management frameworks and competent authorities should monitor its fulfilment.
3. The results of the EU-wide stress test are expected to be published in early Q3 2016. The 2016 EU-wide stress test does not contain a pass fail threshold and instead is designed to be used as a crucial piece of information for SREP in 2016. The results will thus allow competent authorities to assess banks' ability to meet applicable minimum and additional own funds requirements under stressed scenarios based on a common methodology and assumptions. These results will provide solid ground for discussions with individual banks to better understand (i) relevant mitigating management actions and (ii) how a bank's capital position may be affected by the adverse economic conditions.
4. As stated in the EBA Guidelines on common procedures and methodologies for the SREP (SREP Guidelines), competent authorities are expected to factor the results of the EU-wide stress test, together with other stress tests and capital planning assessments, into their assessment of banks' ability to meet applicable own funds requirements over the economic cycle¹.
5. In particular, competent authorities should use the quantitative results of the EU-wide stress test to assess whether the quantity and composition of available own funds would allow under

¹ Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP), EBA/GL/2014/13, Article 339. Available here: <http://www.eba.europa.eu/regulation-and-policy/supervisory-review-and-evaluation-srep-and-pillar-2/guidelines-for-common-procedures-and-methodologies-for-the-supervisory-review-and-evaluation-process-srep>

the assumed scenarios an institution to meet the total SREP capital requirements (TSCR²), determined under the SREP capital assessment, under severe economic conditions, and the impact on the Overall Capital Requirements (OCR).

6. The incorporation of the quantitative results of the EU-wide stress test into SREP assessments will generally involve the following:

- a. competent authorities will discuss the quantitative impact of the stress test with the institution and understand the extent to which credible management actions may offset some of the impact of the adverse scenario. As the EU-wide stress test is conducted on the assumption of a static balance sheet, the assessment may also take into account some natural dynamics in the balance sheet, based on existing strategic and capital planning;
- b. competent authorities will assess the net impact of the stress test on the institution's forward looking capital plans and its capacity to meet applicable own funds requirements, in particular TSCR under the conditions assumed in the adverse scenario of the stress test;
- c. if the analysis of the quantitative results demonstrates that there may be potential breaches of the TSCR over the stress test time horizon, however there is no imminent risk of the institution breaching the TSCR, competent authorities may consider whether any measures are necessary for the institution following the analysis required in paragraph 366 of SREP Guidelines;
- d. competent authorities may also consider requesting changes to the institutions' capital plan. Such changes may take a number of forms such as potential restrictions on dividends required for a bank to maintain the agreed trajectory of its capital planning in the adverse scenario;
- e. additional measures may include setting additional supervisory monitoring metrics in the form of capital guidance, above the combined buffer requirement, taking into account all available capital. In cases where capital guidance is provided, that guidance will not be included in calculations of the Maximum Distributable Amount, but competent authorities would expect banks to meet that guidance except when explicitly agreed, for example in severe adverse economic conditions. Competent authorities have remedial tools if an institution refuses to follow such guidance.

7. However, competent authorities are not restricted to the measures above as the following aspects in particular may also influence the SREP conclusions:

² Total SREP Capital Requirement (TSCR) is defined in the common SREP guidelines as the sum of own funds requirements as specified in Article 92 of Regulation (EU) 575/2013 and additional own funds requirements determined in accordance with the criteria specified in the SREP guidelines.

- a. the qualitative outcomes of the stress test, including identified deficiencies in risk management and controls, hidden concentrations, previously unaccounted weaknesses in specific portfolios, or data management and reporting issues that have not been previously factored into the SREP assessment, might lead to the revisions of the conclusions on the four main SREP elements³;
 - b. the quantitative outcomes of the EU-wide stress tests may suggest that there is imminent risk of the institution not being able to meet its TSCR. Considering the actual macroeconomic conditions, following the analysis required in paragraph 366 of SREP Guidelines and considering the probability that the scenarios leading to the TSCR breaches can materialise in short term, competent authorities may consider updating the SREP assessments and reviewing the TSCR.
8. In line with the SREP Guidelines, it is important for competent authorities to explain to institutions the rationale and general underlying principles behind the use of the stress testing results in SREP, especially where it might be used as one of the inputs for the determination of the additional own funds requirements.

³ Four main SREP elements are (1) business model analysis, (2) assessment of internal governance and institution-wide controls, (3) assessment of risks to capital, and (4) assessment of risks to liquidity and funding.