

CEBS draft revised Guidelines on stress testing (CP32)

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Testing Task Force (STTF)

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CEBS

Committee of European
Banking Supervisors

Outline

- Role and tasks of CEBS
- Framework of CEBS guidelines and standards addressing Pillar 2
- Background and introduction to the revision of guidelines
- Structure of the revised Guidelines – “building blocks” approach
 - Governance aspects and infrastructure
 - Stress testing methodologies
 - Portfolio, individual risk level and firm-wide stress testing
 - Outputs of stress testing programme and management intervention actions
- Supervisory review and assessment
- Implementation and follow-up work

The role of CEBS – main objectives and tasks

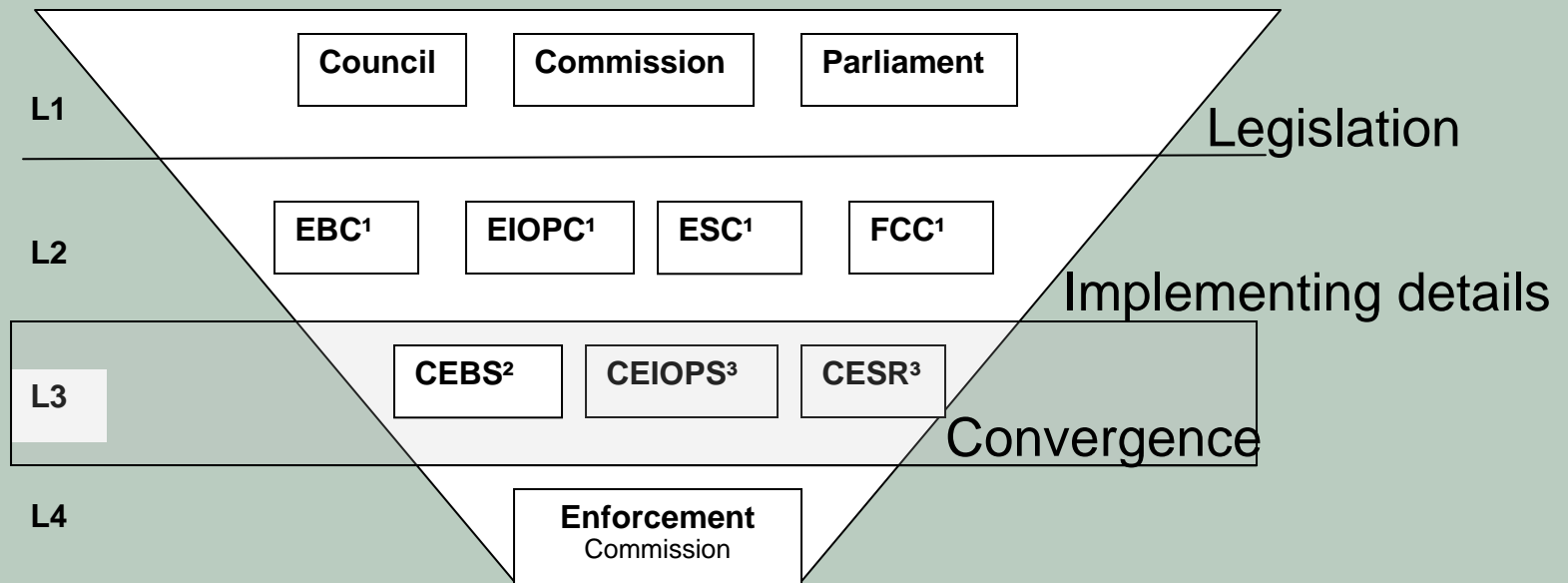
Objectives:

- Promote efficient and effective supervision and the safety and soundness of the EU financial system through:
 - Good supervisory practices
 - Efficient and cost-effective approaches to supervision of cross-border groups
 - Level playing field and proportionality

Main tasks:

- Give advice to the Commission
- Promote consistent implementation/application of the EU banking legislation
- Promote convergence of supervisory practices
- Promote information exchange and supervisory cooperation
- Efficient and consistent functioning of colleges of supervisors
- Regular risk assessments from a supervisory perspective

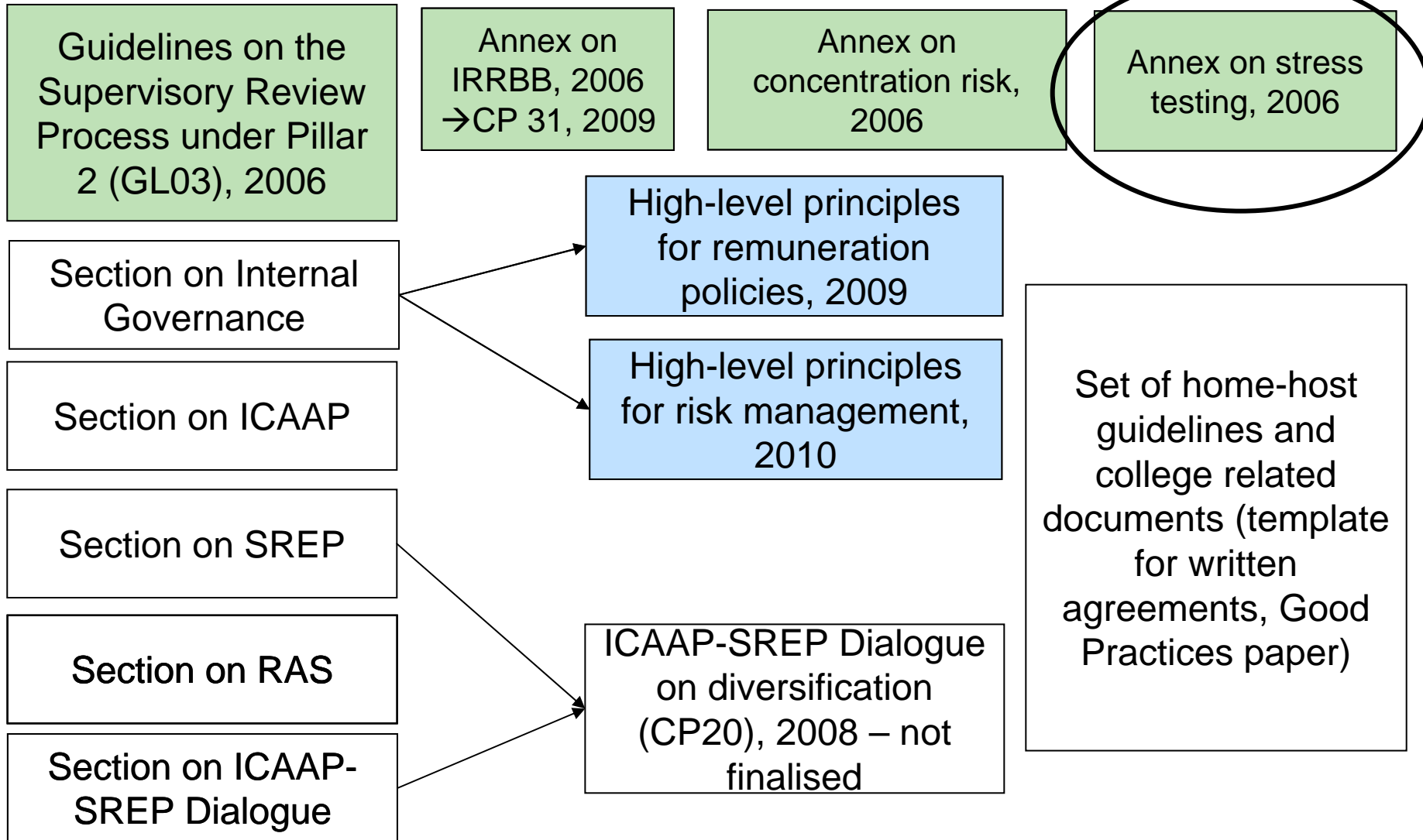
The role of CEBS - the Lamfalussy structure



EBC = European Banking Committee
EIOPC = European Insurance and Occupational Pensions Committee
ESC = European Securities Committee
FCC = Financial Conglomerates Committee
CEIOPS = Committee of European Insurance and Occupational Pensions Supervisors
CESR = Committee of European Securities Regulators

¹ Finance ministries
² Supervisors and Central Banks
³ Supervisors

The current framework of CEBS Pillar 2 Guidelines



Context – the importance of stress testing

Stress testing is an essential risk management tool helping institutions to identify, assess and mitigate risks in their business

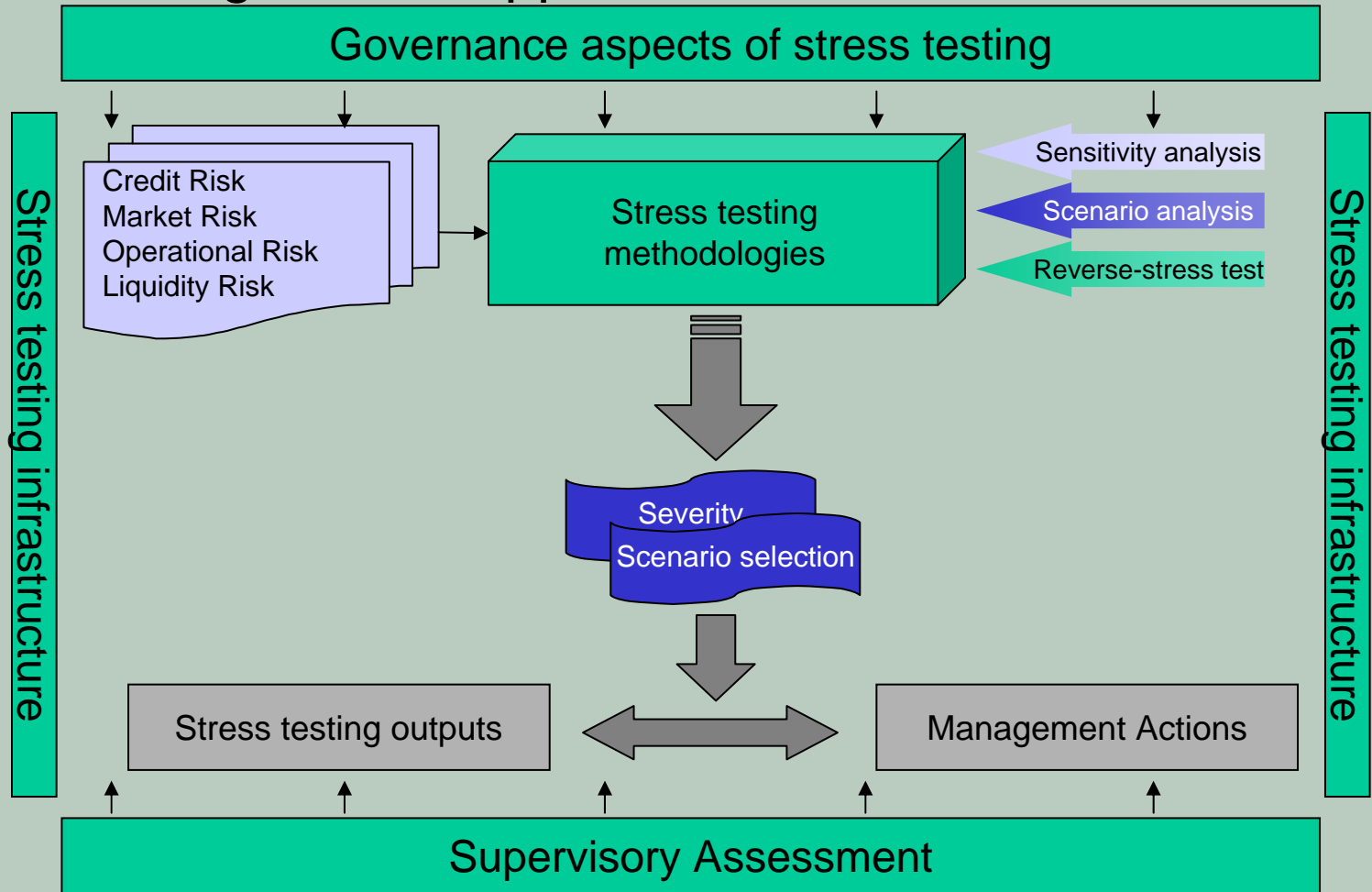
- Stress testing practices and methodologies have developed in recent years and in particular following the recent financial crisis
- Lessons learned:
 - Insufficient integration into institutions' risk management frameworks or senior management decision-making
 - Scenarios were not sufficiently severe
 - Lack of consideration of confluences of events, risk concentrations and second-round effects

Context – drivers for the revision of the guidelines

- Lessons learned from the crisis
- Wider use of stress testing as management and supervisory tool – increased role of stress testing in ICAAP-SREP dialogue
- Overall update and revision of the CEBS Pillar 2 guidelines to reflect on the experience with the implementation of Pillar 2 in Europe and increase convergence
- Comprehensive revision of the Basel Committee on Banking Supervision's (BCBS) of its Principles for sound stress testing practices and supervision (May 2009)

CP32 – What's new

- “Building blocks” approach

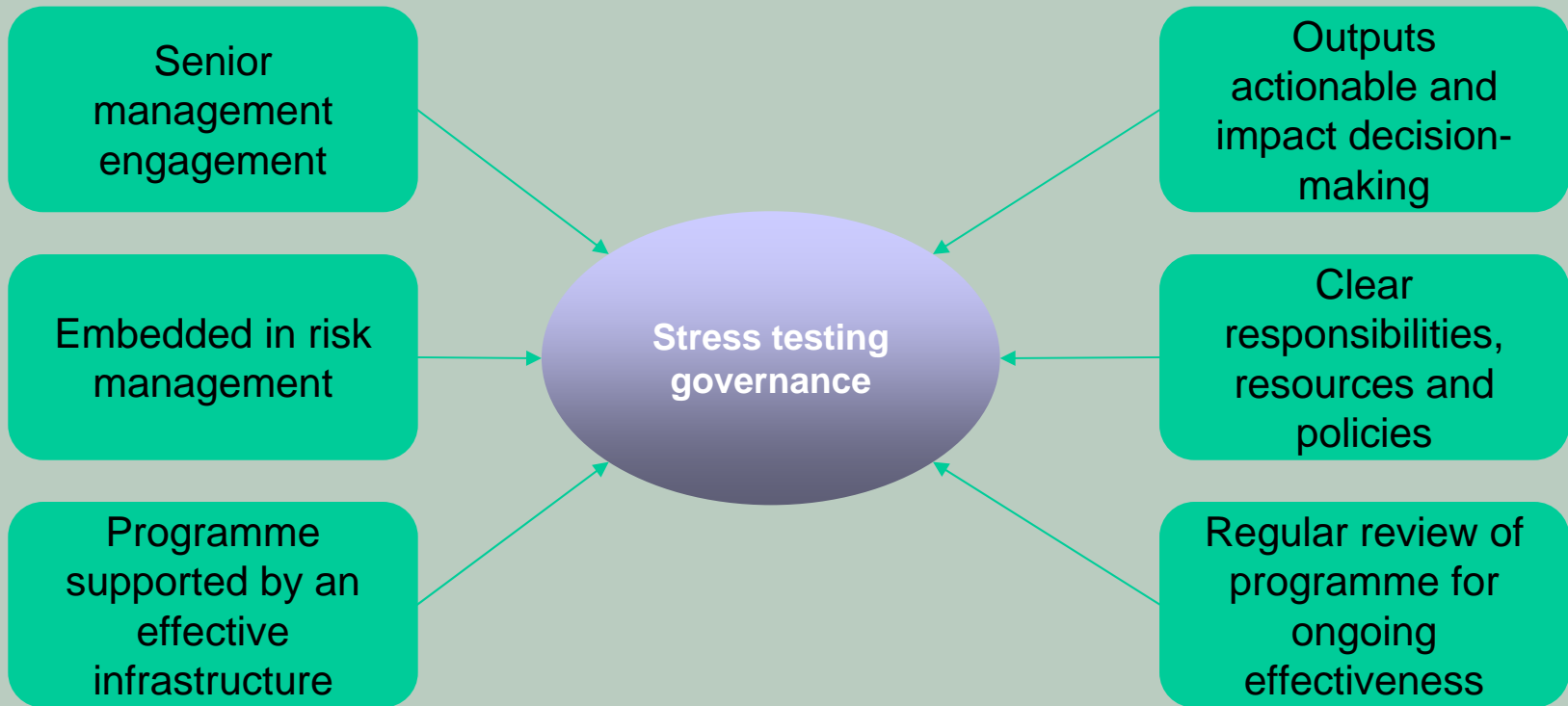


CP32 – What's new

- Reverse stress testing
- More detail on capital planning stress testing under ICAAP

Section 2: Stress testing governance

- Guidelines 1 – 5 cover the following:

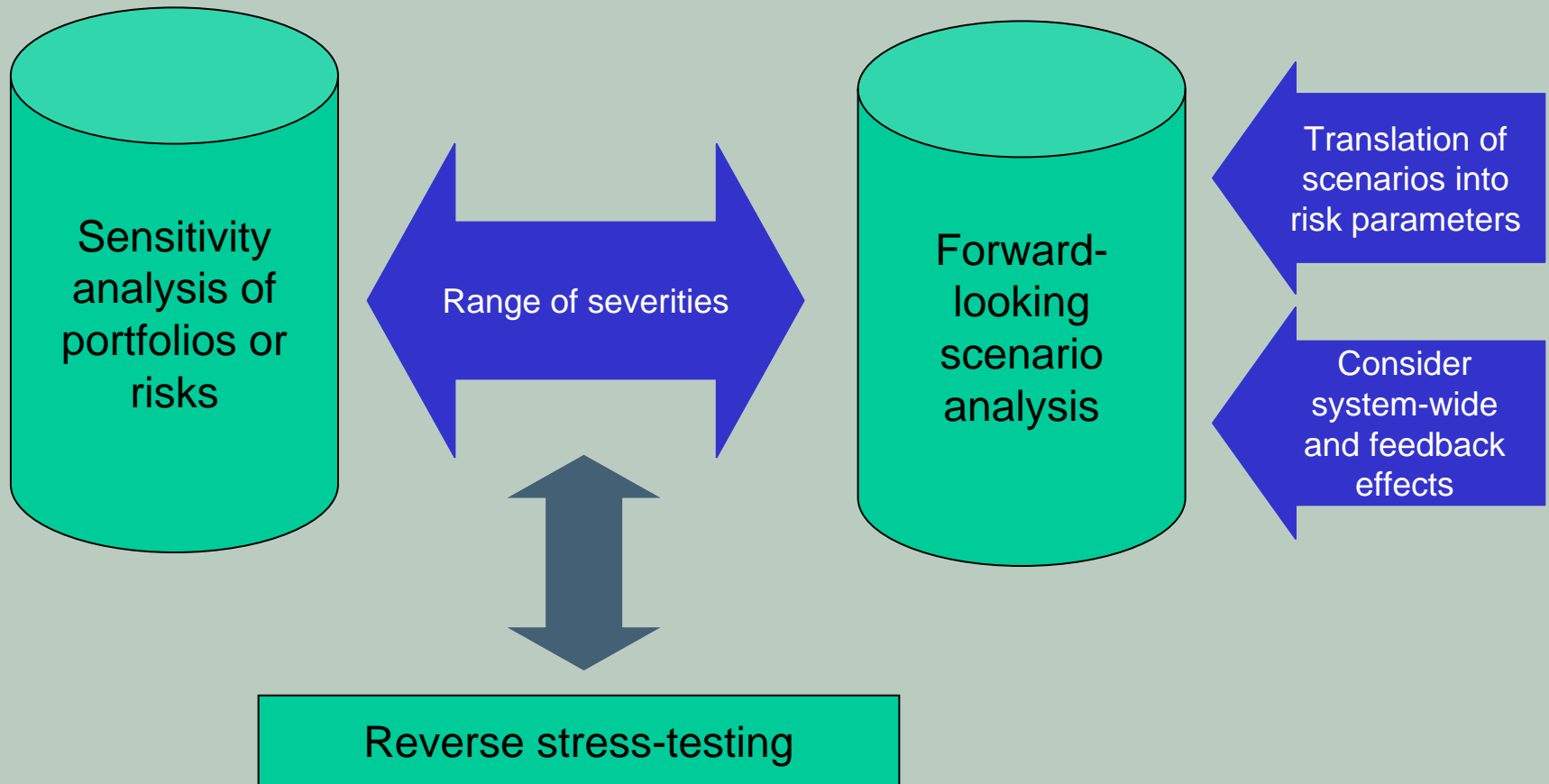


Discussion points

- Do you see distinctions between the roles of the Management Body and Senior Management in the stress testing process?
- Building an effective infrastructure and embedding it into risk management processes is key. What specific steps are required?
- What do we mean by stress testing being actionable?

Section 3: Stress testing methodologies

- Guidelines 6 - 11 cover the following:

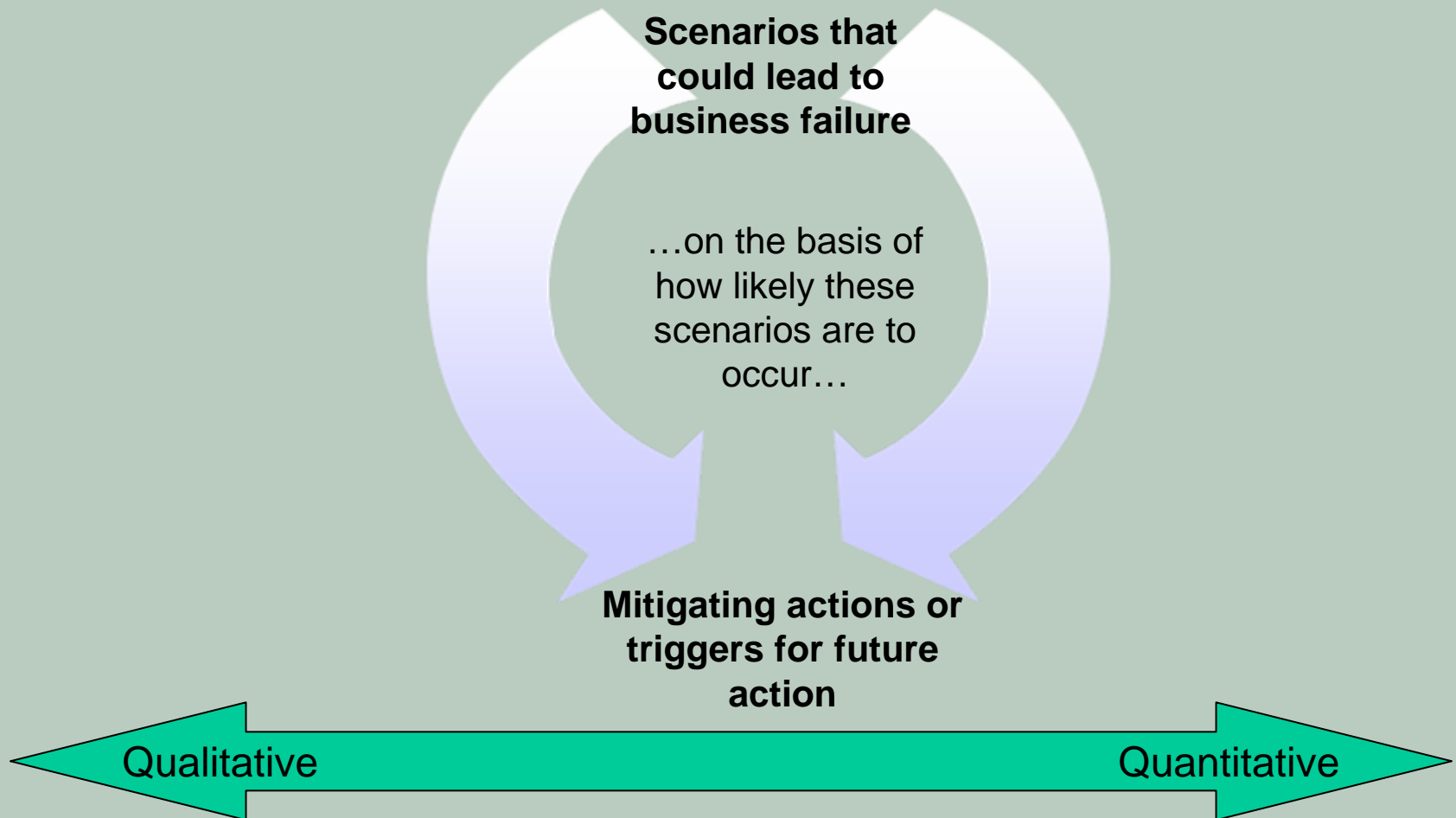


Discussion points

- We have expanded our views on appropriate scenarios. What are your views on the balance between guidance on the range and severity of scenarios being tested and the degree of prescription?
- What guidance (if any) is useful in terms of translating scenarios into institution-specific impacts on individual risk drivers?
- Do you agree that institutions should make efforts to understand system-wide interactions?

Reverse stress testing

- Guideline 11: Reverse stress testing

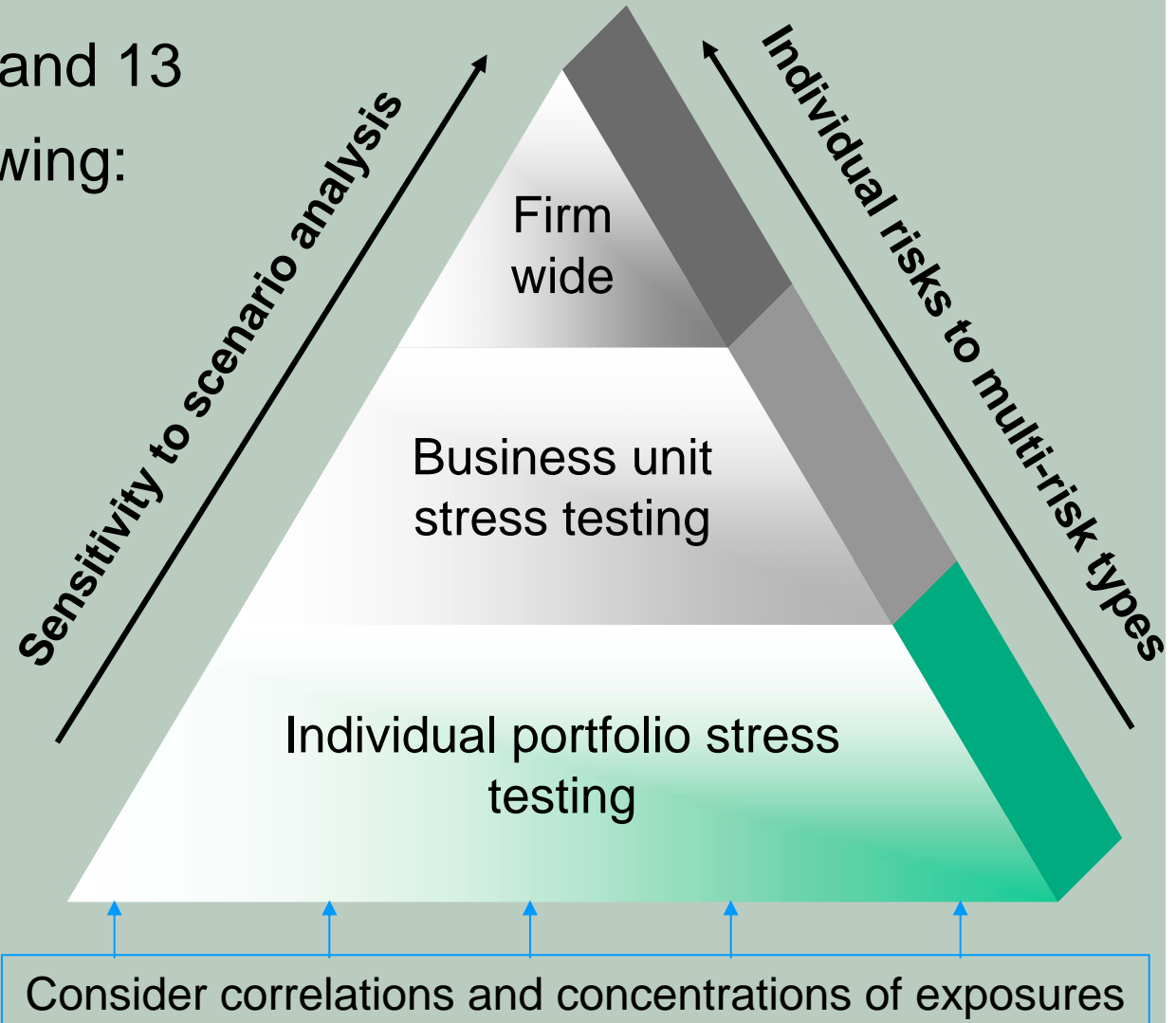


Discussion points

- To what extent is reverse stress testing already undertaken?
- Have we been clear that it is a risk management tool and not a capital assessment?
- Do you understand the balance between qualitative and quantitative approaches to reverse stress testing, and specifically in relation to proportionality?
- Do we need more examples to assist institutions in developing their approaches?

Section 4: Multi-layered approach

- Guidelines 12 and 13 cover the following:

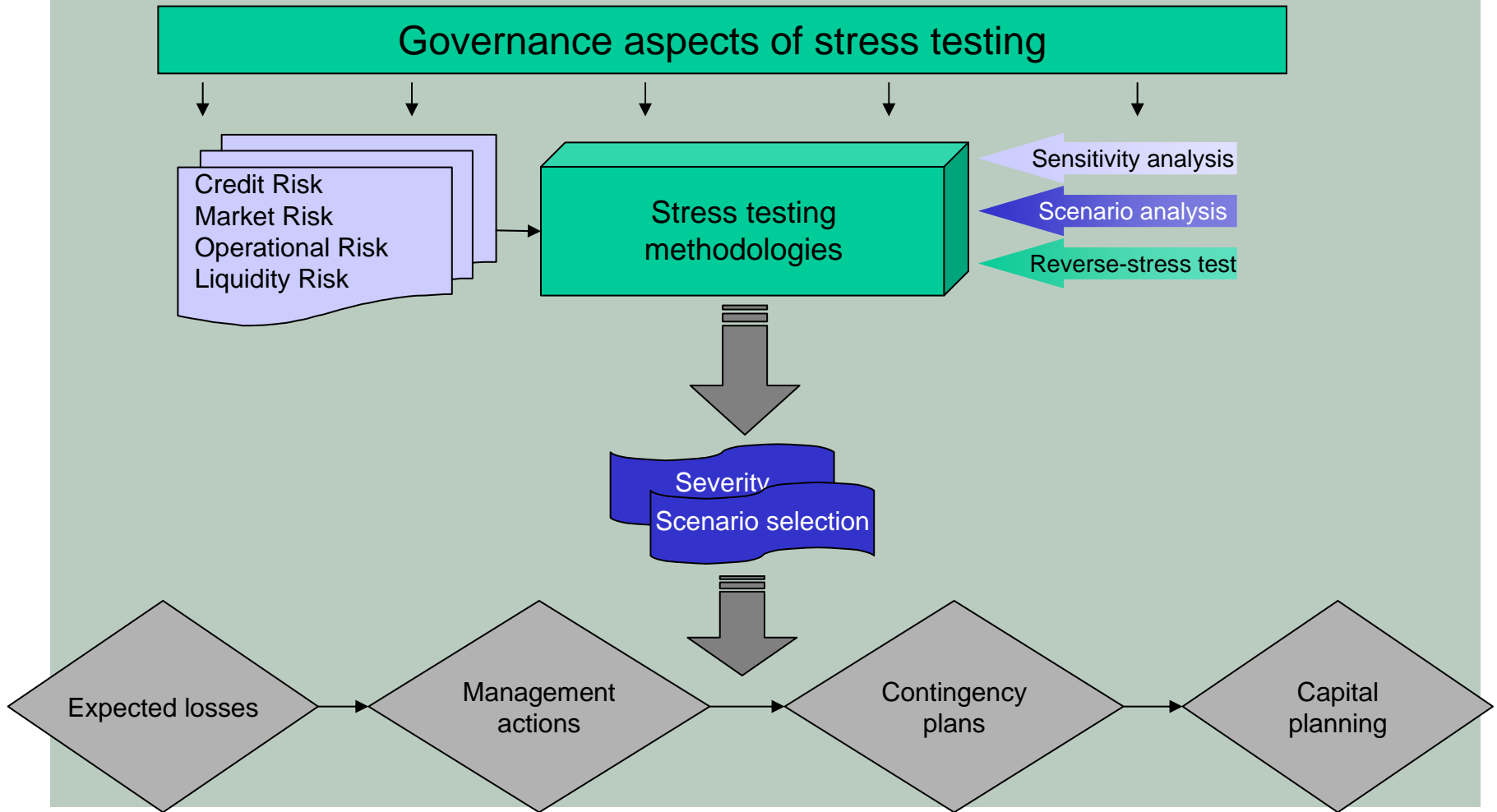


Discussion points

- Do you see firm-wide stress testing as a an aggregation exercise?
- Are our points about correlations and concentrations adequately captured in the existing text?

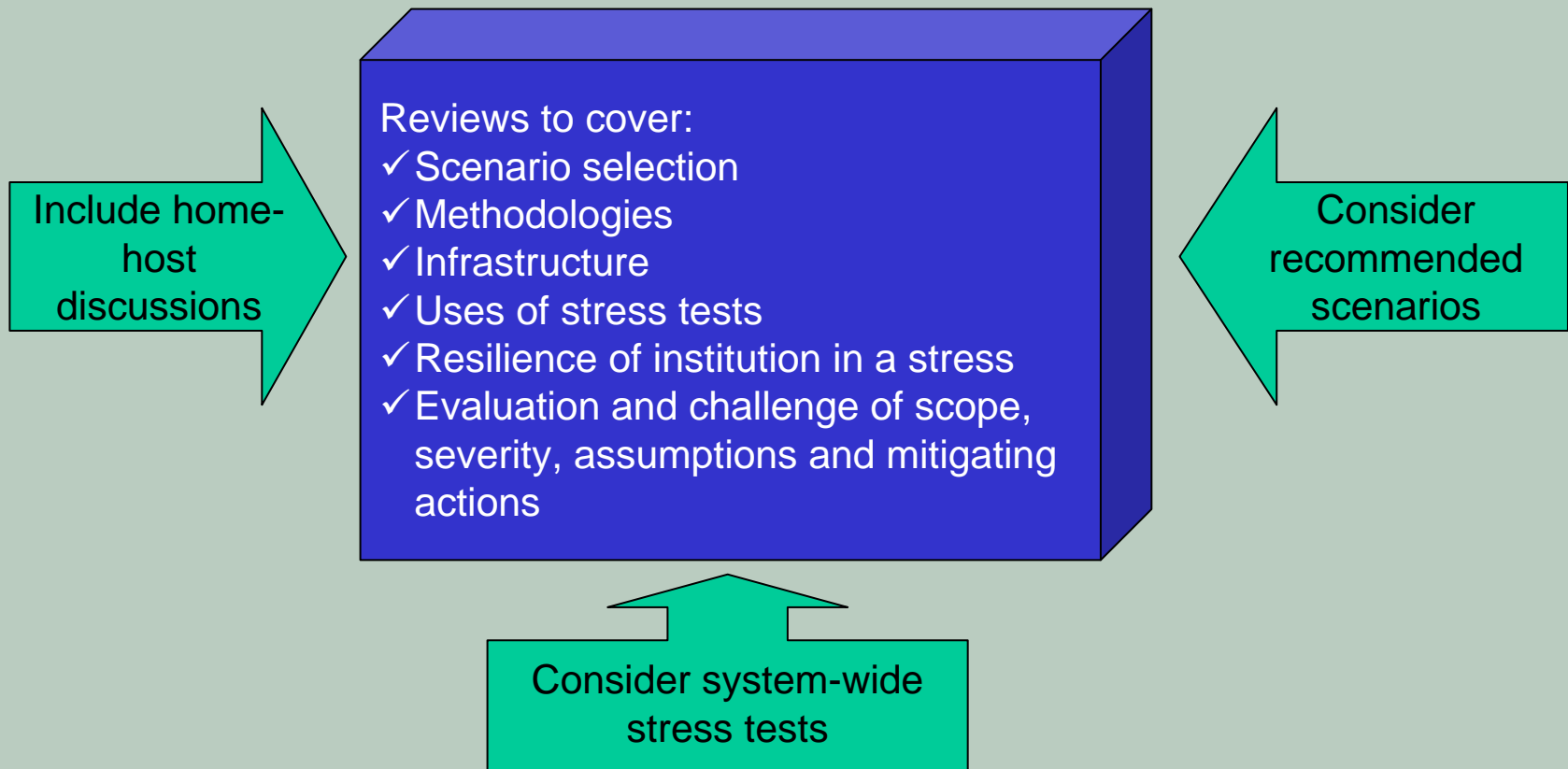
Section 5: Stress testing outputs

- Guidelines 14 – 17 cover the following:



Section 6: Supervisory review and assessment

- Guidelines 18 – 22 cover issues relating to supervisory reviews of stress testing programmes



Discussion points on outputs and P2

- Are more specific details or guidance needed on expected stress testing outputs and their uses?
- What has been your experience of mitigating management actions in recent years and do you agree that their credibility in a stress should be assessed?
- Do you agree that there should be a clear link between risk appetite, strategy and capital planning stress tests?

Annexes – individual risk areas' specificities

- Set of risk area specific annexes with principles applicable to all institutions and those using advanced models to compute regulatory capital requirement
- Annexes covering:
 - Market risk
 - Securitisation
 - Credit and counterparty risk, including financial collateral values
 - Operational risk
 - Liquidity risk
 - Interest rate risk from non-trading activities
 - Concentration risk

Implementation

- CEBS will expect its members to apply the present guidelines, once finalised, by 30 June 2010
- Phased implementation (from simple to more complex approaches) and flexibility from national supervisors regarding the implementation of specific aspects (e.g. reverse stress testing)
- Implementation will be monitored by national authorities
- CEBS will conduct an implementation study in 2011

Immediate follow-up work and next steps

- Public consultations runs until **31 March 2010**
- Please send your written comments to the following e-mail address: cp32@c-eps.org
- Comments received will be published on CEBS' website unless respondents explicitly request otherwise
- Final version of the document will be available in June 2010

Questions and answers

- Do attendees agree with the broad principles covered in the guidelines?
- What issues could be flagged to CEBS to keep in mind in the finalisation of the guidelines?
- What further work can the CEBS do to help institutions to implement the guidelines?



Thank you!

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