EBA 2019 Policy Research Workshop
"The future of stress tests in the banking sector: approaches, governance and methodologies"

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Introductory remarks of José Manuel Campa, Chairperson of the European Banking Authority

Check Against Delivery
Seul le texte prononcé fait foi
Es gilt das gesprochene Wort

Welcome to our eighth Policy Research Workshop, taking place for the first time at our new premises in Paris. I am glad to see that we have gathered together so many colleagues, supervisors and researchers for this conference. I was told this is a popular annual event in the supervisory community, but it is the first time that we have such a large number of participants.

We have an interesting but difficult topic – the future of supervisory stress tests – to deal with, a rich agenda and excellent papers and speakers. All the ingredients for a successful exchange of views. This conference is also very timely for us since we are close to launch the 2020 EU-wide stress test and, in parallel, we are considering possible changes for improving the value added to our exercise in the longer-term.

The upcoming 2020 exercise will be in line with the one we ran in the past. We have aimed at keeping the methodology stable, while improving some aspects based on our lessons learnt and banks' feedback. As we decided not to introduce fundamental changes to the approach, the EU-wide stress test is going to be constrained bottom-up, a key input for the supervisory review and evaluation process (SREP) and a comprehensive disclosure exercise. Compared to the past, we agreed to publish Pillar 2 requirements and clarify how the maximum distributable amount (MDA) rules are applied, which should make the publication of the results more informative.

The debate for the longer-term is open and there are several options – including the *status quo* – currently under discussion. We entered this process with an open mind and the commitment to consult widely the different stress test users before making any final decisions. We have taken stock of the stakeholders' views and we have now a clear picture of the benefits of the current approach, but also of its limitations.

While its main objective has shifted over time, the EBA stress test has provided a crucial contribution to the strengthening of EU-banks' capital positions. During the crisis, when there were concerns on the level of capital of European banks, the emphasis was on identifying specific recapitalisation needs. Since 2016, the focus has moved on supporting the supervisory dialogue and Pillar 2 decisions.

The EU-wide stress test has been very successful in increasing transparency. Horizontal comparability has been a constant feature over time and remains a significant contribution of the exercise. It has helped discern which banks are weaker and more sensitive to shocks, rank them and explain risk drivers and exposures. Undertaking a concurrent stress test exercise in a coordinated fashion has delivered consistent and comparable outcomes across the Single Market. EU banks are no longer a black box for investors – as they were in 2011 – and analysts appreciate the effort we put in enhancing disclosure, as part and beyond the stress test exercise. On Friday this week, we will publish our annual EU-wide Transparency exercise, for the first time providing quarterly data.

Considering the sample of banks involved, the jurisdictions covered and the number of authorities contributing to the exercise, our stress test is – I believe – a successful example of concurrent stress test and inter-institutional cooperation. We should be proud of what we have delivered, but this should not prevent us from frankly assessing whether there is room for improvements. We may then ponder whether we need ordinary maintenance and repairs or fundamental changes to the framework.

Let me mention the key shortcomings we have identified.

First, compared to other jurisdictions, the EU-wide stress test is less integrated in the supervisory process. While the stress test serves as an input for the SREP, the static balance sheet assumptions and some methodological constraints make the results a starting point rather than the end of the supervisory assessment, whose outcome is not always disclosed. Investors understand the rationale for a non-pass/fail setting, but want clarity on the implication of the stress test in terms of capital distribution.

Second, while the publication of the results is increasingly seen as a "non-event" by market participants, the EU-wide stress test is still perceived by many banks as a beauty contest rather than a risk management tool. The incentive could thus be to minimise the impact and, possibly, game the methodology. The challenge I see is to balance the need to have an assessment that is useful for banks with safeguards for ensuring the credibility and severity of the results.

Third, the constrained bottom-up approach has the merit of incentivising banks' risk management while ensuring consistency and comparability across banks. But it is a hybrid approach based on a delicate balance between *ex-ante* constraints and *ex-post* reviews. The outcome of the exercise is a figure – expressed in terms of capital depletion – which is the result of banks' own estimates, the methodological constraints set by the EBA and supervisory add-ons from the quality assurance process. Over time, striking the right balance has become more and more difficult. The ownership of the results is, therefore, questioned: supervisors consider the exercise predominantly bottom-up, while banks feel they are required to sign-off figures, which are not necessarily reflecting their own assessment.

Fourth, such a large-scale exercise tends to be complex and costly in terms of supervisory and bank resources. The quality assurance process – particularly if concentrated in a few months – can become very intensive and burdensome for all parties.

The question is, therefore, whether there is room for improvements, within the boundaries of existing resources, EBA mandates and the EU institutional setting.

A couple of weeks ago I put forward some options for discussion[1]. My starting point was that, in a constrained bottom-up approach, there are two components of the overall

[1] Jose Manuel Campa (2019), "The EU-wide stress test: can the glass be more than half full?" speech at the 20th Handelsblatt Annual Conference on European Banking Regulation, Frankfurt.

assessment: one – more idiosyncratic and potentially more optimistic – owned by banks and the other one – more standardized and conservative – under the control of the supervisors. It is probably time to make the existence of these two components more explicit. In such a framework, the supervisory leg of the exercise would be similar to the current approach, where banks submit their bottom-up projections based on methodological constraints. The bank's leg would allow, instead, banks to make full – possibly unconstrained – use of their models. Both legs would use a common scenario and possibly they would share the same starting points.

The supervisory leg would still be a constrained bottom-up approach and it would be the basis for the supervisory decisions. Banks would submit – as they do today – their projections that would undergo the supervisory quality assurance. Supervisors would own this part of the exercise and banks would not be required to sign off these results. The overall quality assurance process would become lighter for them as it would require less iterations. Results would be relevant for supervisors and comparable.

The bank leg would obviously leverage on the bottom-up approach with less – or potentially no – constraints. The methodology would be much less prescriptive but still contain common templates for reporting. The results would not be quality assured and would be owned by the banks. Less constraints and no quality assurance should make the burden of this component relatively minor. In principle, this part of the exercise could be very close to the internal capital adequacy assessment process (ICAAP), at least for banks able to demonstrate that their models are robust and reliable.

These two views should form the basis for a discussion between the banks and supervisors on what are an institution's weaknesses, priorities and necessary follow-up actions.

What to do with the two outcomes is not an easy choice. One option would be to reconcile the two assessments in order to end up with a single estimate – perceived as the "right" figure by both supervisors and banks – to be published in line with today's standards. The other option is to keep the two outcomes separate, publish both of them, and explain the differences. Regardless of the path we take, disclosure cannot be less than it is today. This implies publishing results that allow banks to better explain their business models and provide a clear and direct link with the supervisory decisions, including the amount of Pillar 2 guidance.

As I said, these are preliminary ideas that we need to discuss and assess further before going public with a concrete proposal. We are coordinating closely with the competent authorities and the ECB in order to agree on a shared framework that can be then discussed with the industry.

Also, I focused on the bottom-up stress test – since this is our current approach – but as we develop top-down tools along the way, it does not necessarily have to be the only game in town. While challenging, developing a full top-down model should be an ambition, at least as a support to the quality assurance process. This would also give us the flexibility to perform ad hoc analyses, more tailor-made sensitivities on specific business models, and to cover liquidity risk. Depending on the level of sophistication, top-down models can also provide the technology for assessing the impact of non-financial risks, such as cyber and climate-change.

I am sure that the debate over the next two days will provide us with additional ideas and help shape our longer-term vision on the EU-wide stress test.

Let me conclude by thanking all the colleagues who have contributed to the organisation of this event, particularly the members of the Programme Committee. My special thank goes to Samuel da Rocha Lopes and Eva Jauernik, the real engines of this workshop.

Now I would like to welcome back at the EBA Andrea Enria – Chair of the Supervisory Board of the European Central Bank – for his keynote speech.

Thank you very much for your attention.