



GL on Stress Testing and Supervisory Stress Testing

Public Hearing – 29 February 2016, EBA London

- The development of taxonomy is a key first step in the review of the stress test guidelines
- Setting the stage for any discussion of a future EU-wide stress test
- **Key stress test terms are defined** (examples):
 - Bottom-up stress test; Top-down stress test;
 - Static balance sheet assumption; Dynamic Balance Sheet assumption
 - Sensitivity analysis; Scenario analysis
 - Reverse stress test
 - Severity of scenario; Plausibility of scenario
 - Risk data aggregation; Data infrastructure
- Basel work and alignment in progress.

- Lessons learned from the global financial crisis
- **Guidelines aligned with Basel Principles for SIBs (BCBS 239):**
 - Satisfactory **Governance** and adequate **IT Infrastructure**
 - Data aggregation must be accurate, timely, flexible and cover all material risks and levels of consolidation
 - **Reporting** must be also clear, tailored to the appropriate recipients and available on demand (internally and externally – supervisors)
- Mirror BCBS 239 principles **on risk reporting:**
 - *(...) accurately and precisely conveys aggregated risk data and reflects risk in an exact manner (...); (...) meaningful information tailored to the needs of the recipients (...)*
 - Data are **aggregated on a largely automated basis** so as to minimise the probability of error
 - Ensure that is able to **produce aggregate risk information on a timely basis** to meet all reporting requirements

- Now, an **integral part of the reviewed Guidelines** (not annexes anymore)
 - increasing the prominence of specific practices on difficult areas (e.g. **Liquidity risk**)
 - updated to align stress test GL with SREP GL, i.e. requirement for assessing risks to liquidity and funding in SREP GL
 - In addition, consideration of new regulatory requirements, i.e. LCR, NSFR
 - the inclusion of **FX lending risk** and **conduct risk** as suggested by the ESRB

4.6 Individual risk areas

4.6.1 Credit and counterparty risk

4.6.2 Securitisation

4.6.3 Market risk

4.6.4 Operational risk

4.6.5 **Conduct related risk and associated litigation costs**

4.6.6 **Liquidity risk**

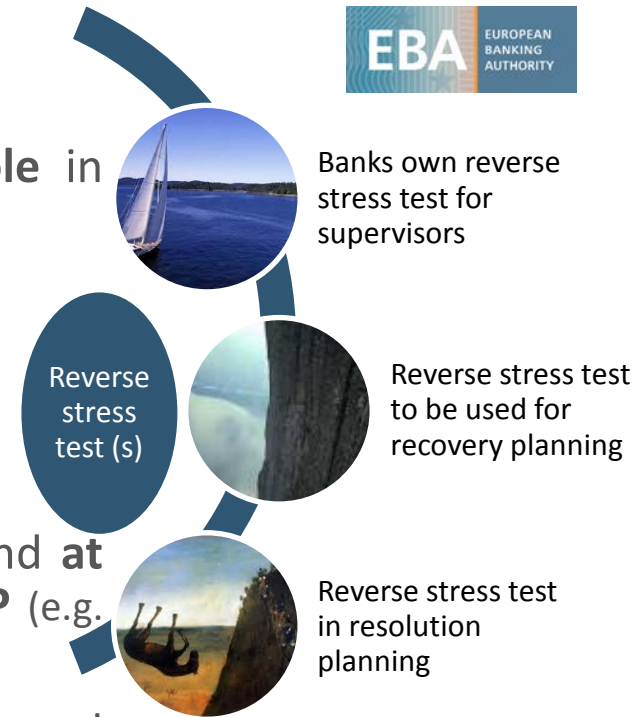
4.6.7 Interest rate risk from non-trading activities

4.6.8 Concentration risk

4.6.9 **FX lending risk**

The use of reverse stress testing process

- Identified by the peer review process; Growing role in recovery and resolution (FSB; EBA; others)
- Right incentives (3 pages) - Institution should:
 - part of the stress testing programme
 - regular risk management tool;
 - carried out regularly by all types of institutions and at the same level of application as ICAAP and ILAAP (e.g. institution-wide and covering all relevant risk types)
 - sharing the same governance and quality standards and to complement other types of stress testing (...)
- Consideration of **proportionality** (institution's size as well as the nature, scale, complexity and riskiness of its business activities).
- Use of **specific reverse stress test for recovery plans** clarified in order to
 - develop scenarios (non-viable business model); and
 - as an input to inform and test the effectiveness of recovery actions and recovery planning, and analyse sensitivities around respective assumptions.



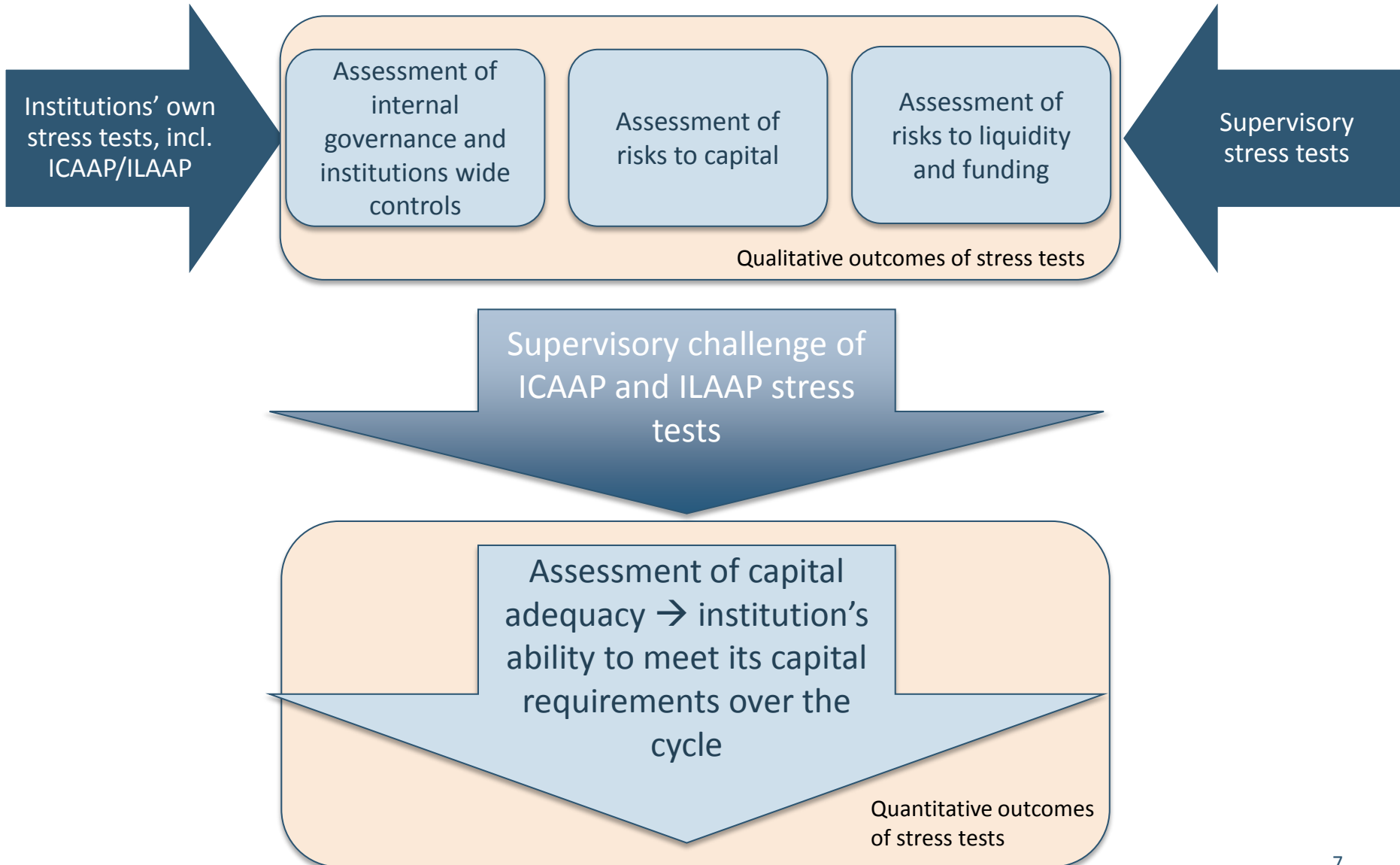
■ Structure

- simple but also complete, consistent and integral guidance per process;
- **consistency between the SREP and the supervisory stress testing** and how stress testing feeds into SREP (appropriate cross-referencing);
- **functional for the supervisors/addresses** - a comprehensive guidance; and
- avoids the sub-optimal solution of legislating by reference

■ Clarifies

- that CAs should ensure that an **institution submit or has submitted a credible capital plan** (not necessarily a new submission of the revised capital plans if the institution has already submitted) that addresses the risk of not meeting its TSCR (paragraph 364 of the SREP Guidelines);
- explain various uses of stress tests in SREP
 - ▶ use of stress tests for risk assessment purposes (Section 5); and
 - ▶ focusing only on the use of quantitative outcomes of solvency stress test (Section 7).

Using results of stress testing in SREP



Meeting requirements over the economic cycle

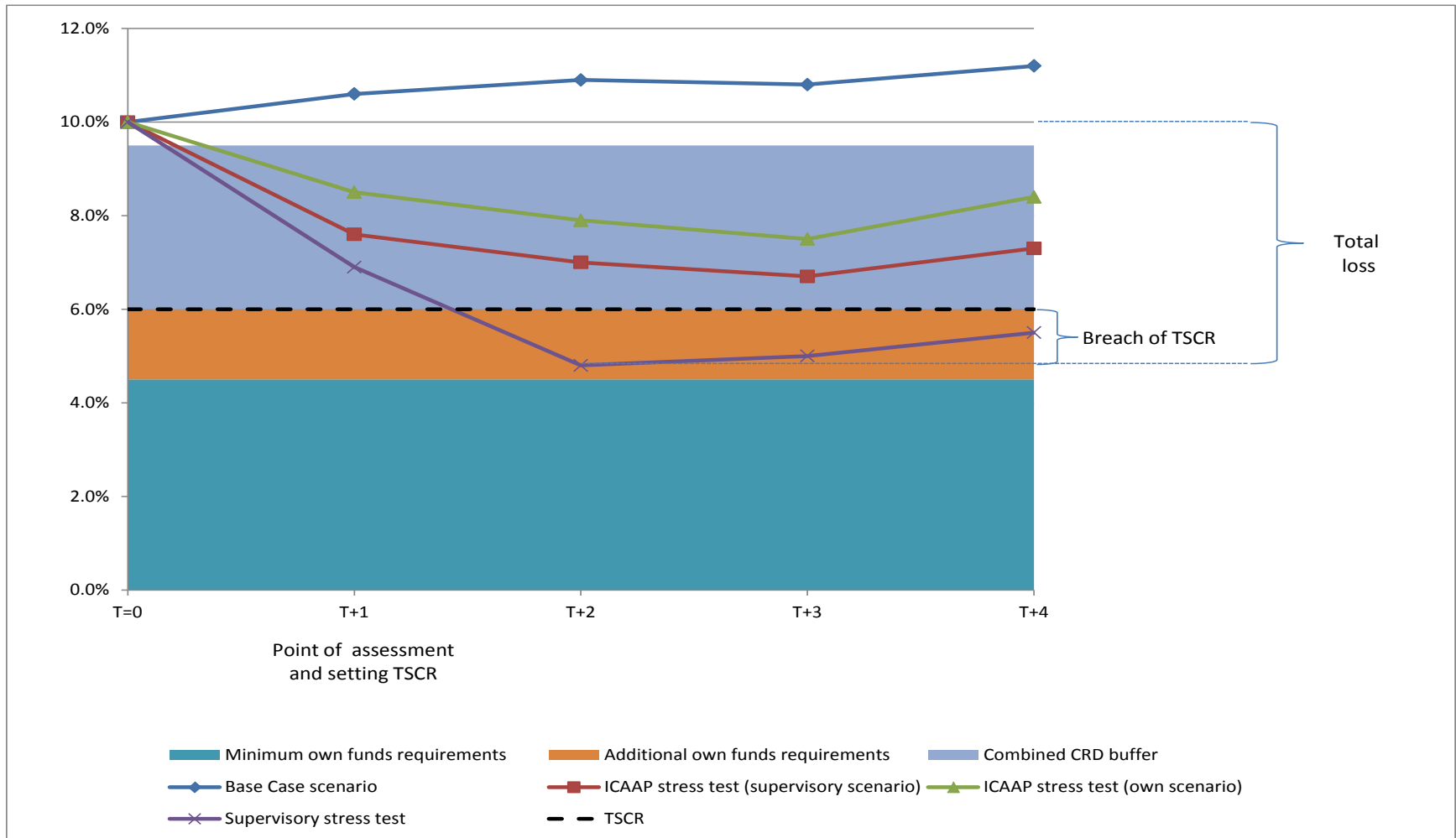
Issues to keep in mind when reviewing the outcomes of the stress tests:

- The starting point for resources should be the institution's available own funds at the start of the stress
- Focus is to ensure that an institution can meet:
 - OCR under the baseline scenario over a forward-looking time horizon of at least two years
 - TSCR under the adverse scenarios over a forward looking time horizon of at least two years
 - *any other pre-defined target ratio set by the competent authority in the context of a system-wide stress test under the adverse scenarios over a forward looking time horizon of at least two years*

To identify a breach of the OCR, any assumptions with regard to macroprudential requirements (e.g. changes in the level of requirements or which buffers can be used) over the scenario horizon should be discussed with the macroprudential (designated) authority, however:

- General assumptions that CRD combined buffer can be breached under the adverse scenario, but not under the baseline

Illustrative example





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