



European Banking Industry Committee

European Banking Federation (EBF) • European Savings Banks Group (ESBG) • European Association of Cooperative Banks (EACB) European Mortgage Federation (EMF) • European Federation of Building Societies (EFBS)
European Federation of Finance House Associations (Eurofinas)/European Federation of Leasing Company Associations (Leaseurope)
European Association of Public Banks (EAPB)

Brussels, 29/09/2006

RESPONSE

CONSULTATION PAPER 12 – STRESS TESTING UNDER THE SUPERVISORY REVIEW PROCESS

The European Banking Industry Committee (EBIC) welcomes the opportunity to comment on CEBS' proposed guidelines for stress testing under the Supervisory Review Process (SREP). We note that the consultation paper has clearly benefited from the dialogue conducted with the Consultative Panel on an ongoing basis, and we appreciate that the proposal is more principles-based and less detailed than previous considerations on the subject.

The comments below reflect the main common viewpoints of the European Banking Industry. In addition, several EBIC member associations submit their own more detailed responses to CEBS.

General remarks

On the whole, the EBIC finds CEBS' proposal helpful. We agree that **stress testing is an important part of the risk management process**, as rightly set out in Paragraph 18. We moreover welcome CEBS' proportionate approach, which acknowledges that stress testing is not a box-ticking exercise but has to be defined by the bank itself, in accordance with its size, sophistication and diversification. It is therefore appropriate to request that banks conduct stress testing on the **parameters that they identify themselves as material**. This principle of proportionality will have to be reflected in the dialogue between the bank and its supervisor under the Supervisory Review Process. We also underline that, in addition to the mentioned factors, account must be taken of the proportional size of an entity within a group, the significance of specific business lines and the institution's risk profile.

However, we wish to note that the usefulness of stress testing depends on the **availability of meaningful data and on highly sophisticated IT facilities**. CEBS' requirements should take account of these limitations, as well as consider the cost and work load implications. Indeed, as it currently stands a significant share of the European banks would be unable to comply with the requirements of the paper. This is especially the case for Europe's smaller credit institutions, for which stress testing is a relatively new issue. To some extent, though, the requirements also go beyond the current practices applied in bigger institutions. We would request CEBS to clarify in the executive summary that **the guidelines should be seen as a longer-term aspiration**. We would also ask CEBS to reconsider in particular the guidelines on credit risk. In our view these are **too detailed**, and we would question their value especially for smaller institutions.

Furthermore, the EBIC believes that too much reference is made to capital add-ons throughout the paper. As we pointed out in our response to CEBS' CP 03 (revised) on the application of the Supervisory Review Process, **additional capital is only one among a range of possible measures. Indeed, it should be seen as the measure of last resort.** We welcome the fact that CEBS explicitly leaves the choice of the appropriate measures to the financial institution and suggest that CEBS review the many references to capital add-ons with a view to deleting a significant number of them.

Specific remarks

- We agree with CEBS' description of the use and aims of stress testing (Paragraph 18). Notably, we welcome CEBS' acknowledgement that institutions' net income is the first line of defence to absorb losses. Every institution should be free to decide on the level of losses acceptable for its specific business model.
- ST 9 foresees that supervisors may require ad hoc stress tests if deemed necessary for specific reasons. We acknowledge the principle but underline that we would **expect these ad hoc stress tests to be very exceptional.** Furthermore, as regards the purpose of assessing the impact of similar stress tests across a range of institutions, we highlight that each institution uses parameters and methodologies specifically designed for its own portfolio. As a result, the outcomes of stress tests may not be comparable across a range of institutions. In addition, we question the obligation to conduct stress testing for academic purposes, especially in view of the implementation burden that the new capital requirement provisions already imply for institutions.
- In our view, some of the proposed provisions are still too detailed and should be reformulated to focus instead on the principles. This concerns especially ST 10 (Paragraphs 37 and 38), as well as the sections on credit risk and on macro-economic stress tests (Paragraphs 59 to 66).
- We call on CEBS to **delete all references to the management body**, for example under ST 12, ST 14 and ST 15. The responsibilities of the management are sufficiently specified in CEBS' guidelines on the Supervisory Review Process. Repeating them in the current paper bears the risk of contradictions, confusion and additional prescription, to which we would object.
- We agree in principle with ST 16, i.e. that institutions should consider periodically whether stress tests are still adequate. However, we have reservations about the interpretation of this principle in Paragraph 48. The yearly review should not apply to the process as a whole, but should **merely serve to reconsider the assumed scenarios and processes.**
- According to ST 17 (Paragraph 52), also future business plans should be taken into account in the context of stress testing. In our view, future business plans, i.e. the formulation of growth strategies, are a part of the budget planning process of the financial institutions and should therefore not be subject to stress tests. We suggest deleting the paragraph.

- We agree with ST 26, subject to the supervisors' strict adherence to the principle that their own stress tests have to be based on data that is already available. Indeed, these stress tests must not lead to any additional work load for the institution.