



2016 European Union Stress Test Process: Methodology and practice

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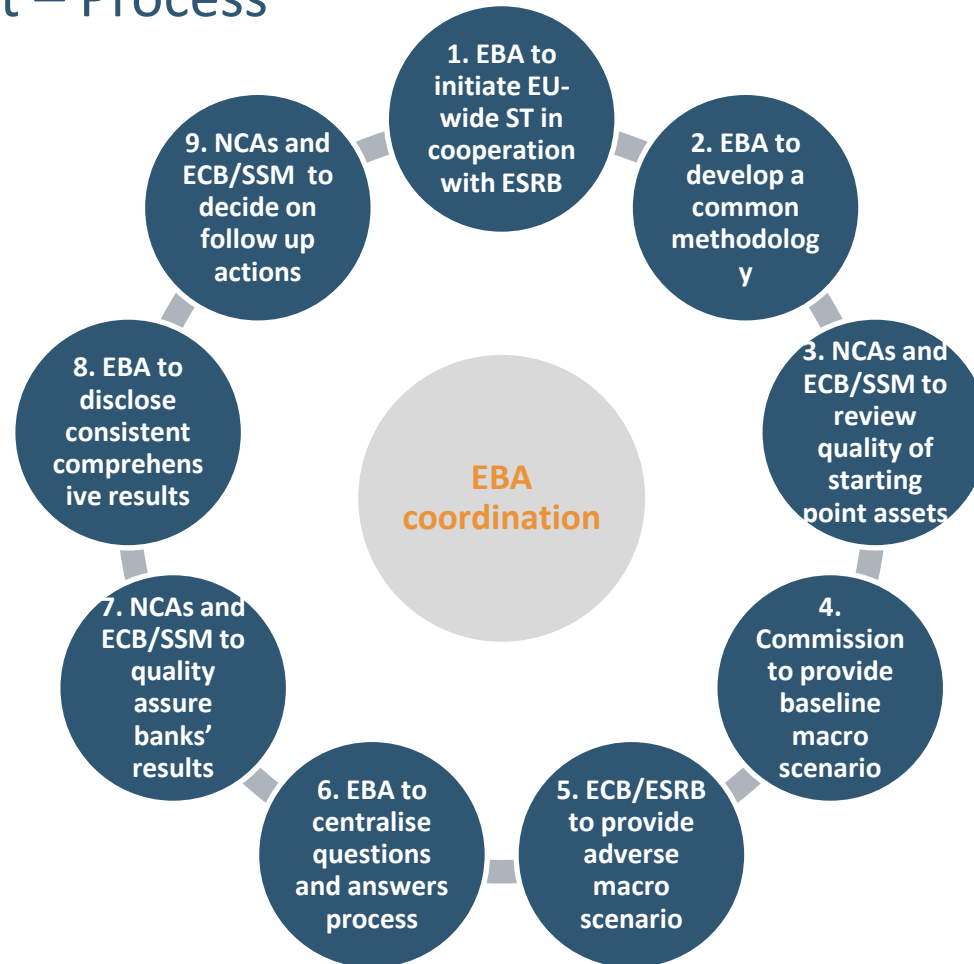
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Outline



- 2016 EU-wide stress test
 - Process and roles
 - Main features
 - Scope
 - Sample of banks
 - Review 2014
 - General changes to the methodology
 - Key changes to the methodology by risk type
 - Treatment of conduct risk and other operational risks
 - Timeline

EBA stress test – Process



2016 EU-wide stress test – Main features

Bottom-up static balance-sheet approach

- In line with previous exercises, the 2016 exercise will be conducted by banks following a bottom-up and static balance sheet approach.
- Banks' projections will be subject to conservative constraints that will be included in the EBA methodology.
- Banks under restructuring are subject to the same assumptions including the static balance sheet.

Not a pass-fail exercise but an input for SREP

- As a novelty, the 2016 exercise will not be a pass-fail exercise, i.e. not capital threshold was defined.
- It will be an important input for the 2016 supervisory review and evaluation process (SREP) under the responsibility of competent authorities.
- For this purpose all main regulatory capital ratios will be assessed including fully loaded ratios and the leverage ratio.

Common baseline and adverse scenarios over three years

- The stress test will be based on a common baseline and adverse scenario.
- The time horizon of the exercise will be 2016 – 2018 based on data as of end-2015.

2016 EU-wide stress test – Scope

Solvency stress test

- Covering the impact of stressed risks on capital and profitability

Credit risk

- Including securitisation exposures
- Including sovereign exposures
- Explicit treatment of FX lending

Market risk

- Including sovereign exposures
- CVA
- Counterparty credit losses

Net interest income

- Interest income
- Interest expenses

Conduct risk and other operational risk

- Newly added to scope for 2016

Other income and expenses

- Any effects not captured in other risk types
- Some room for treatment of “one-offs”

2016 EU-wide stress test – Sample of banks

The exercise is conducted at the highest level of consolidation.

The sample covers broadly 70% of total banking sector assets in the Eurozone, each other EU Member State and Norway. For countries with a large share of foreign subsidiaries of EU-banks a smaller coverage is possible.

Banks have to have a minimum of EUR 30 BN in assets.

Competent authorities could request to include other institutions in their jurisdiction provided that they have a minimum of EUR 100 BN assets.

Banks under European Commission restructuring plans can be included subject to the common methodology and static balance sheet assumption if they are near the completion of the plans.

The sample of banks includes 53 banks – 39 from SSM countries and 14 from other countries.

EBA stress tests – Review of 2014: methodology



Process

- + Stress test completed in line with overall timeline
- + Enhanced transparency to stakeholders along the process
- Coordination of full exercise remains as challenge
- Complexity and resource requirements
- Consistency of quality assurance

Scenario

- + Appropriate severity and plausibility
- + Appropriate risk coverage
- Consistency vs relevance
- Application of scenario for all risk types e.g. credit / market / operational?

Methodology

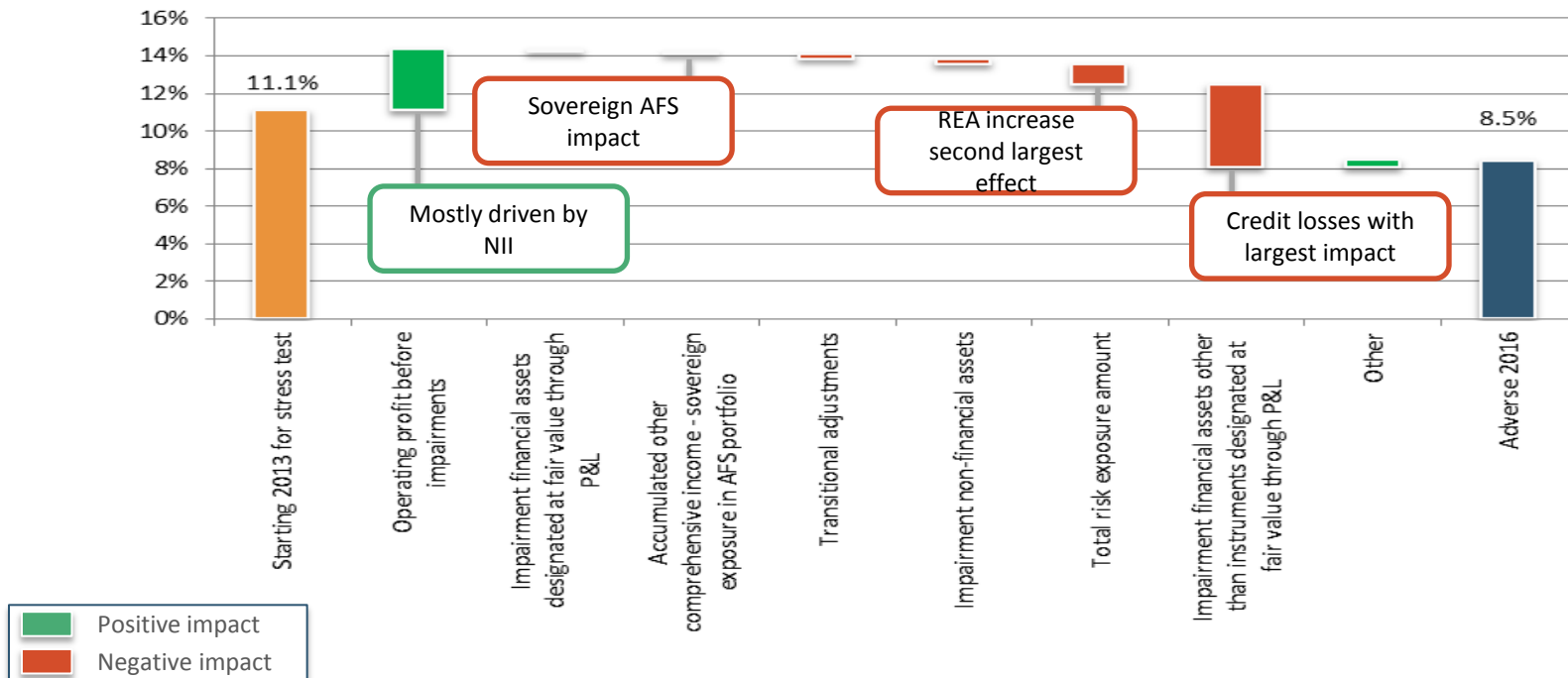
- + Impact and consistency due to constraints such as caps / floors
- Market risk impact
- Funding methodology

Data and communication

- + Managing expectations, effective explanation of objectives
- + Transparency of scenario and methodology ex ante
- + Extensive transparency of the results with consistent data
- + Effective data infrastructure with significant testing

EBA stress tests – Review of 2014: drivers

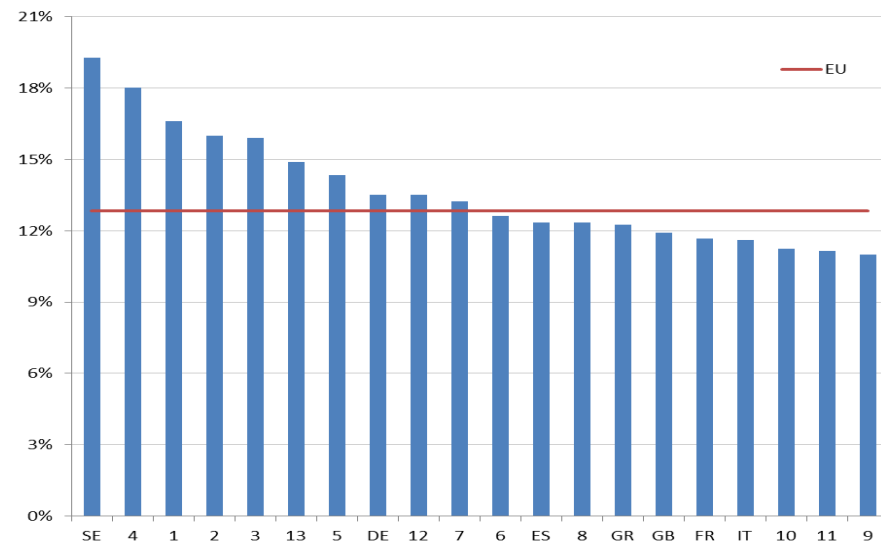
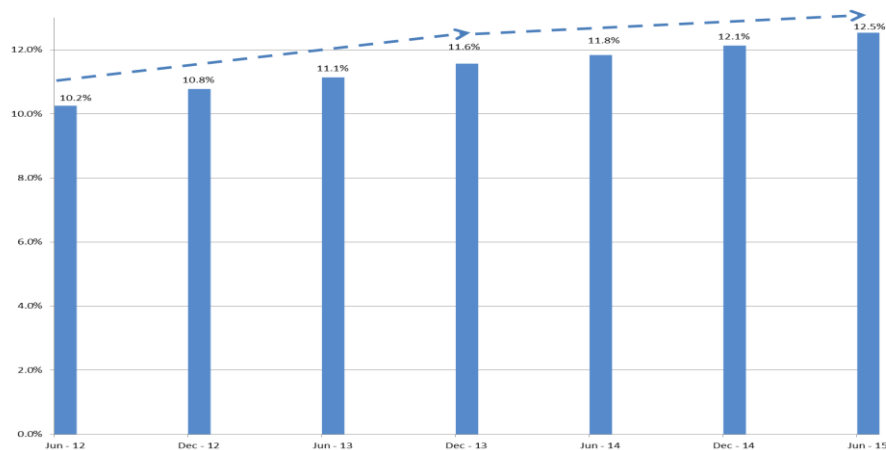
Contribution of different drivers to the change in Common Equity Tier 1 Capital ratio from 2013 to 2016 in the adverse scenario



EBA stress tests – Review of 2014: impact



Evolution of the CET1 ratio. Source: KRI



EBA stress tests – General changes to draft methodology



Constraints

- Constraints were enhanced to ensure were necessary a more conservative and consistent approach.

Application

- The full approach was reviewed to make it easier to apply for banks as well as for competent authorities in the quality assurance process, e.g. by detailing the explanations in the methodology or bringing the methodology more in line with banks internal approaches.

Simplification

- Where possible the methodology was simplified.
- However, consistency and inclusion of key new risks, e.g. FX lending and conduct risk, were prioritised over an overall simplified approach.

Data requirements

- Templates were constructed to serve the different purposes of all involved authorities, e.g. for gathering results and for the quality assurance process.
- Templates were further aligned with supervisory reporting.

2016 EU-wide stress test – Key changes to methodology



| Credit risk | Market risk | Net interest income | Conduct risk and other operational risk | Other income and expenses |
|---|--|---|---|--|
| <ul style="list-style-type: none">▪ Methodology similar to 2014▪ Use of specific provisions for old defaulted assets | <ul style="list-style-type: none">▪ Simplification regarding number of scenarios and application▪ More conservative constraints▪ Further detailed changes, e.g. to take portfolio changes over 2015 and hedging into account | <ul style="list-style-type: none">▪ Separation of reference rate and margin▪ Application of pass through constraints on margin only▪ Introduction of an idiosyncratic component for liabilities (calibration to be finalised) | <ul style="list-style-type: none">▪ Newly added to scope for 2016▪ Banks' internal estimates for P&L impact▪ Relying on quantitative and qualitative interaction with competent authorities▪ Quantitative floors defined | <ul style="list-style-type: none">▪ Fixed stress effect for main components▪ Possible adjustment of costs for one-off effects |

2016 EU-wide stress test – Timeline



| Time | Milestone |
|-------------------------------------|--|
| November 2015 | Publication of the sample |
| November 2015 | Publication for informal discussion with industry of preliminary draft methodology and templates |
| November 2015 | Workshop with banks |
| December 2015 – January 2016 | Finalisation of methodology and templates |
| December 2015 – January 2016 | Testing of templates |
| End-February | Publication of final methodology and templates |
| End-February | Publication of macroeconomic and risk specific scenarios |
| End-July 2016 (tentative) | Publication of results |



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