



14 December 2006

### **Feedback to the consultation on “Technical aspects of stress testing under the supervisory review process – CP 12”**

1. CEBS published its consultation paper on Stress testing (CP12) under the Supervisory Review Process on 9 June 2006. The consultation period ended on 30 September 2006.
2. Nine responses were received, all were published on the CEBS website. Prior to the consultation CEBS has given industry experts nominated by the CEBS Consultative Panel the opportunity to provide further input at two special meetings with CEBS experts dedicated to CP12.
3. This paper presents a summary of the key points arising from the consultation on the paper and highlights the changes CEBS has made with regard to them. It includes an Annex which reflects CEBS’ detailed views on the public comments.
4. In general, the respondents welcomed CP 12. Many respondents also acknowledged the willingness of CEBS to develop these guidelines in a close dialogue with the industry and the amendments already made before the public consultation of CP 12 as a reaction to the technical meetings with industry representatives.
5. For the purpose of assessing the comments received, CEBS has distinguished between
  - General comments on key issues relating to the concept and content of CP12
  - Specific comments relating to single paragraphs of CP 12.

## General comments

6. The respondents agree with the following points:

- Stress testing is an important part of the risk management process and general guidelines on this topic can be considered a useful exercise.
- Stress testing is still a relatively new area, the respective industry practices are still developing and the implementation of CP 12 has to be regarded from an evolutionary viewpoint.
- Stress-testing should, in general, be conducted at the same level as the ICAAP (highest level of consolidation, where applicable).
- Capital add-ons are only one option to react to negative stress-testing results. They are a possible measure among several others.
- The application of the principle of proportionality throughout the guidelines. Many respondents acknowledged that CP 12 does not lead to a "tick box approach" but leaves room for the particular needs of each institution.

7. However, many respondents expressed concerns with regard to the national implementation and remarked that national supervisors should have realistic expectations about stress testing and about the virtues of such an exercise. They emphasized that stress testing is neither an end in itself nor can it provide a full picture of the risk profile of the activities of an institution, but should rather be considered as delivering valuable complementary insights.

8. Some respondents also emphasized that for systemic events, in their opinion, there must be provisions for external intervention. They claim the intervention threshold should be internationally coordinated.

9. A major concern of the respondents is the statement that it lies in the sole responsibility of the institutions to determine time, scenario and material parameters of the stress tests and also to determine in which cases stress tests can offer added value. With regard to ad hoc supervisory stress tests it was welcomed that according to ST9 "supervisors would discuss with institutions the feasibility of conducting ad hoc supervisory stress tests" (ST9). Some respondents expressed their concerns that the national supervisory authorities might use stress tests in situations which are not considered to be significant by the institution, e.g. stress-testing asked for by host regulators for activities of local entities, stress-testing across a number of

institutions based upon incommensurable individual hypotheses, stress-testing disregarding the 'gap' between academic developments and the implementation process within institutions or stress-testing for hypothetical events. Another respondent expressed doubts whether stress tests imposed by the supervisors on all institutions (or on a group of them) can lead to significant results as each institution uses its own methods and hypotheses which makes it impossible to compare the results. One respondent suggested adding a specific principle to the guidelines stating that for IRB institutions that are already subject to stress testing in Pillar I it should, at least at first, be possible to limit the requirements to more easily realized stress tests.

CEBS agrees that stress-testing is an internal tool for the institutions and that it lies primarily in the discretion and responsibility of the respective institution to determine whether, when and how it conducts stress tests. Moreover, para 5 already explicitly takes into account that many institutions will have to "grow" into stress testing and that the requirements depend on the development of its practices over time. However, the question whether an institution has to conduct stress tests at all is in some cases already answered by explicit requirements in the CRD.

10. The respondents agree that capital add-ons are only one option to react to negative stress-testing results and that they are typically a measure of last resort. One respondent required a reduction of the number of references to the capital add-on in the guidelines. Another respondent considers direct links between stress testing and additional capital requirements completely unacceptable.

CEBS sees no need to revise the guidelines in this respect. Capital add-ons are clearly marked as being only one option to respond to stress testing results. Besides, stress testing is also part of the ICAAP and as such naturally connected with the assessment of the internal capital of the institutions.

11. A number of respondents proposed to reconsider the degree of detail in the guidelines and the use of examples throughout the guidelines and the annexes. On the other hand, some respondents asked to include examples for possible stress testing scenarios and relevant risk parameters as well as a clearer definition of "exceptional but plausible".

CEBS has considered these proposals and has deleted examples where it was deemed adequate. CEBS believes that given the fact that stress testing is a new area for many institutions as well as supervisors for the time being it could be valuable to have more detailed guidelines illustrated with examples. On the other hand, a more detailed definition of “exceptional but plausible” or a specification of scenarios was not added as it could easily be too prescriptive and contradict the proportionate approach to stress testing.

12. Two respondents pointed out that Sections I, II and III of the CP deal with stress testing in general and are therefore not assigned to a single risk category. They asked for clarification as some of the concepts covered, such as “economic cycles”, are relevant only for some risk categories and not for others.

CEBS has considered this proposal. It agrees with the respondents that not every guideline in Sections I to III is relevant for every risk category. However, especially paragraph 30 clearly suggests that a reference to economic cycles is not a mandatory requirement for stress tests (“may be useful...”, see also paragraph 8). CEBS therefore sees no necessity for an amendment.

13. One respondent suggests that in cases where the type of risk cannot be quantified but estimated using scenario analysis or qualitative methodologies the creation of an additional stress process is not required and asks to include a respective indication.

CEBS guidelines are relying on a broad definition of stress testing as reflected in §9: the term may include various techniques including qualitative ones (namely incorporating general 'what if scenarios'). Accordingly, when risks are not quantifiable, qualitative methodologies can be perfectly acceptable. All this considered, CEBS does not see the need for amendments on the this regard (as no *further* stress tests would be required)

14. Three respondents criticized overlaps with other CEBS Guidelines and proposed to work with cross-references.

Cross-references were included for example in paragraph 28 or ST6.

### **Specific comments**

15. One respondent thinks that operational risk stress testing is not addressed in a consistent manner in the guidelines. The respondent proposes to add a specific sub-section on operational risk to section IV and to add an annex on operational risk.

CEBS considered this proposal: given the complexity of the issue and the already rather advanced state of work on CP 12, it was decided not to follow it, but rather to reserve it for a later revision of CP 12, in light of implementation and only after re-analysis of this proposal again.

**ANNEX: Feed-back table on CP12**

Draft text CP12	Received Comments	CEBS Analysis	Amended text
<b>Comments on specific paragraphs</b>			
<b>I. Executive summary</b>			
<b>Para 2</b>	Para 2 should clarify that the guidelines will not automatically result in capital surcharges.	Agree with comment. For clarification a cross-reference to ST 14 is added.	Accordingly, they will be (...) automatic capital add-ons <b><u>(see ST 14)</u></b> .
<b>II. Definition and uses of stress testing</b>			
<b>II.2 Types of stress testing</b>			
<b>Para 15</b>	One respondent suggests that the differentiation between “sensitivity analysis” and “scenario tests” in para 15 and 16 serves only illustrative purposes and can be deleted.	Clarify. For clarification para. 17 has been merged into para 15, which already clarifies that this is only one type of categorisation.	<b><u>There are a number of (...) or the supervisors.</u></b> In the context (...) categories and concepts <b><u>described in paragraph 16:</u></b> scenario tests and sensitivity analyses. <b><u>Although for the purposes of this paper (...) as long as these approaches meet supervisory expectations.</u></b>
<b>Para 16</b>	One respondent asks for clarification that there is no need for the use of portfolio models (not mandatory under the Pillar 2), due to the use of the expression “factor model”.	Agree with comment. Clarify by replacing “risk factors” by “risk drivers” in the whole document.  Clarify.	Sensitivity analyses (...) in one particular risk <b><u>driver</u></b> , the source (...) impact of simultaneous moves in a number of <b><u>risk drivers</u></b> , the stress event being well-defined. (...) <b><u>“Black Monday”-like event</u></b>

	Use of the example of a "Black Monday", may give the impression that scenario tests may only be based on scenarios that have occurred in the past.	To be more general replace "black Monday" by "'black Monday'-like event"	on an institution's (...) combination of changes in different <b>risk drivers</b> being affected (...).
<b>II.3 Uses of stress testing</b>			
<b>Para 18</b>	<p>A few respondents suggest that the decision as to which capital components shall be included in the stress tests is left to institutions' discretion, as it is not clear why institutions are required to compare the results of stress testing with earnings and at the same time consider stress testing as an internal instrument.</p> <p>A respondent argues the statement "Stress testing helps form a view where paucity of historical data limits the predictive power of such [internal capital] models" is generally not correct.</p> <p>And it also defends that a complete integration of (in general nonprobabilistic) stress tests within formal probabilistic internal capital models (e.g. VAR models) can be methodically very difficult. Suggests replacing the expression "should be used" contained in the last bullet under para 18 by "could be used".</p>	<p>Agree with comment. Earnings paragraph shifted to be first sub-bullet point of second bullet point ("As a forward looking tool under the ICAAP"). Earnings paragraph: replace "should assess" by "should consider assessing".</p> <p>Agree with comment. Paucity of historical data sub-bullet point: replace "Stress testing helps form a view" by "Stress testing helps form an alternative view"</p> <p>Agree with comment. Statistical methodologies sub-bullet point: replace "stress testing should be used to supplement statistical methodologies" by "stress testing could be used to supplement statistical methodologies"</p>	<p>Therefore, institutions <b>should consider</b>, in the context of their ICAAP, <b>assessing</b> how their earnings are affected by stress situations.</p> <p>For institutions using internal capital models, stress testing <b>could</b> be used to supplement statistical methodologies (such as VaR). Stress testing helps form <b>an alternative</b> view where paucity of historical (...)</p>

<b>III. Main guidelines underpinning sound stress testing by institutions</b>			
<b>Section III</b>	One respondent claims for an explicit note that the infrastructure set up for implementation of stress tests should be geared towards the risk category under review.	Agree with comment. Wording in last sentence of ST2 changed accordingly: insert "adequate and proportionate" stress tests. About the proportionality issue see para 21.	In general, institutions should conduct <b>adequate and proportionate</b> stress tests on all the risks they have identified as material.
<b>Para 20</b>	One respondent asks for supervisors to develop a common understanding on the definition of an acceptable stress test to avoid a non-level playing field, even though welcome the freedom to choose methodologies and scenarios.	Disagree with comment. As the industry repeatedly and very strongly emphasizes it would be very difficult to develop such a definition. Developing common understanding may result only into some principles that that could be interpreted as a "tick-box" approach.	
<b>III.1 Relevance depending on the size and sophistication of institutions</b>			
<b>ST1. The Guidelines on stress testing will be applied to all institutions taking into account their size, sophistication and diversification</b>			
<b>ST1</b>			
<b>Para 21</b>	<p>Some respondents ask for the extension of the proportionality and materiality principles in order to weigh the value of additional risk management information against additional costs of stress testing exercises.</p> <p>Some respondents suggest amending the first sentence of para 21 to allow sophisticated institutions to use sensitivity analysis <u>and/or</u> scenario tests.</p>	<p>Disagree with comment in all cases where CRD requires stress testing (regardless of the size of the bank). For the rest see para 5.</p> <p>Disagree with comment. Sophisticated institutions cannot only use sensitivity analysis. In order to identify their risks they should apply both sensitivity analysis and scenario tests.</p>	



**III.2 Stress testing coverage**

**ST2 In line with one of the principles listed in the CEBS Guidelines on the Supervisory Review Process (ICAAP 7) institutions should identify their material risks. In general, institutions should conduct stress tests on all the risks they have identified as material.**

<b>ST2</b>	Some respondents recommend changing the last sentence of ST2 to 'should consider conducting stress tests on all....' since stress testing is not necessarily an appropriate response to all the risks a firm faces, even if they are material.	Agree with comment. Wording in last sentence of ST2 changed accordingly: insert "adequate and proportionate" stress tests.	In general, institutions should conduct <b>adequate and proportionate</b> stress tests on all the risks they have identified as material
<b>Para 22</b>	One respondent asks for clarification that the risks identified under ICAAP shall form the starting point for establishing banks' material risks which may become subject to stress testing	Agree with comment. Reference on ICAAP 7 already given on para 23. See next comment.	
<b>Para 23</b>	One respondent favour the deletion of the last sentences of each of the indented, bulleted sub paragraphs, since those are considered too prescriptive.	Disagree with comment. Keep last sentences but reinforce the link to ICAAP 7 of GL 3.	<b><u>In line with ICAAP 7</u></b> , the identification of material risks could stem from:

**III.3 Stress testing calibration**

**ST3. Based upon the identification of material risks, institutions should derive material risk factors that should be subject to stress testing.**

<b>ST3</b>	One respondent notice that more complex portfolios do not automatically require a significantly higher number of risk factors than a less complex one to ensure that a robust stress test is performed.	Agree with comment. Delete §27. [See comment on §27]	
<b>Para 25</b>	A few respondents claim that the list on para 25 should also include "other	Clarify. Insert - "Compliance with regulatory	Institutions should first identify their points of vulnerability in

	limits" (than earnings/profitability and solvency) as the section, as it stands, prejudices how the relevant risk factors should be assessed and tested.	requirements" after solvency	order to stress the relevant risk drivers that may affect their earnings/profitability, solvency <b><u>or compliance with regulatory requirements.</u></b>
<b>Para 26</b>	<p>A few respondents claim that since historical scenarios are already contained in the time series used for risk modelling, repeating them might overbalance past losses, hence better solution would be to review the results of the qualitative analysis (i.e. risk assessments) and incorporate them.</p> <p>One respondent argues it is important to make allowances for the impact of pre-emptive management action in the design of stress tests.</p>	<p>CEBS takes the point but sees no need for change:</p> <ul style="list-style-type: none"> <li>• analysis of past losses is only one possible way to identify material risk factors and institutions can use it but are not forced to;</li> <li>• if results of a qualitative analysis are available, an institution is free to use them;</li> <li>• the most important is that institutions can explain their choices (see para. 28).</li> </ul>	
<b>Para 27</b>	<p>Most respondents say that stressing "all material sensitivities" might be difficult for a number of reasons: (i) degree of a sensitivity is not constant, implying that the set of "material sensitivities" is also not constant; (ii) costs of checking and documenting all material sensitivities could outweigh benefits; (iii) when taking a holistic approach, individually stress sensitivities is difficult as they are invariably inter-related. Recommend deletion of last sentence of para 27.</p>	<p>Agree with comment. Delete §27.</p>	<p>Complete deletion.</p>

<b>Para 28</b>	A couple of respondents suggest the replacement of the word "justify" by the word 'explain' to emphasise that the stress testing process is the institution's responsibility and that there is no need for a regulator to 'approve' it.	Disagree with comment. "Justify" considered more appropriate than "explain". Stress testing does not require prior approval by supervisors. Nevertheless, institutions should be able to discuss its rationale.	
<b>ST4. Depending on their situation, institutions should consider historical and/or hypothetical scenarios.</b>			
<b>ST4/Para 29</b>	Hypothetical scenarios are usually used for calibration, so a few respondents affirm supervisors should not feel concerned if an institution does not apply historical events to its current and prospective portfolio in its stress testing programme as they may never happen again.  One respondent claims that presentations under para. 29 relate to back testing and not stress testing.	Agree with comment. No change needed.  Disagree with comment. The guidelines clearly speak about stress testing and not back testing.	
<b>ST5. Stress testing should be based on exceptional but plausible events</b>			
<b>ST5</b>	First bullet point: risk appetite and internal capital are considered dependent on each other (risk appetite attempts to express the firm's view about the acceptable level of earnings volatility it is prepared to face, which will feed through into its capital position). A few respondents suggest to delete or clarify that an institution does not undertake separate stress tests for internal capital and risk appetite	Agree with comment. 1 <sup>st</sup> bullet point: wording changed from "to assess internal capital and the risk appetite" by "should be consistent".	Stresses and scenarios used <b><u>should be consistent</u></b> with the risk appetite that the institution has set to itself.  when considering historical

	<p>Third bullet point: one respondent claim the deletion of part of bullet that references to 'consider at least one economic cycle' as it might give the impression that it is required to run the impact of the stress forward for the whole period of the economic cycle, rather than to identify particular stresses that might happen during an economic cycle.</p> <p>One respondent call upon the regulators to leave institutions sufficient freedom for their own assessment of the need for stress- testing and of the definition of events.</p> <p>One respondent suggested to re-examine or delete ST 5 as in an initial phase it is difficult to estimate the effect of a stress testing scenario on the bank's future business opportunities.</p>	<p>Agree with comment. Replace in 3<sup>rd</sup> Bullet point "considering ideally at least one economic cycle" by "ideally using data spanning a whole economic cycle".</p> <p>Disagree with comment. CP12 provides institutions sufficient flexibility to design stress tests provided they are compliant with the CRD requirements.</p> <p>CEBS concedes that this estimation might be difficult but as the respondent indicates this would only apply to an initial phase.</p>	<p>scenarios, (...) ideally using <b><u>data spanning a whole</u></b> economic cycle.</p>
<p><b>Para 30</b></p>	<p>One respondent asks CEBS of how can the supervisory authority assess the goodness of the choice of the scenario and of whether a quantitative evaluation is required? And also of whether it is sufficient to cite the resolution of the relevant committee of the bank when deciding not to hold a capital buffer adequate to the results of the stress</p>	<p>CEBS expects institutions to be able to explain their selected scenarios. Quantitative evaluations of of their relevance are not systematically required.</p>	

	<p>test.</p> <p>First bullet point: it seems to suggest that internal capital is derived from stress testing's results and this is not the case for most types of risks and most institutions.</p> <p>Second bullet point: clarification of what is considered as different degrees of severity.</p> <p>One respondent asks for clarification that the requirements contained in this section do not apply to operational risk.</p> <p>Last bullet point: one respondent claims it is too burdensome to request institutions to motivate the measures taken or not.</p> <p>Last bullet point: a few respondents claim the language implicitly suggests that holding a capital buffer is mandatory.</p>	<p>Agree with comment.</p> <p>Replace "used to assess internal <u>capital</u> and the risk appetite by "<u>used should be consistent with the risk appetite.</u>"</p> <p>Covered by change in first bullet point: "should be consistent".</p> <p>No change needed. This paragraph is not specifically intended to address operational risk questions.</p> <p>Disagree with comment: "Motivation" only needed upon request by supervisors. See ST14.</p> <p>This was not intended. 4<sup>th</sup> bullet point: replace "hold" by "keep".</p>	<p>"Stresses and scenarios used <b>should be consistent</b> with the risk appetite that the institution has set to itself."</p> <p>Considering the range of available actions, it is possible that an institution may decide to <b>keep</b> a capital buffer that is not aligned with the exceptional but plausible scenarios performed.</p>
<p><b>ST6. Stress testing should in principle be applied at the same level as the ICAAP</b></p>			
<p><b>ST6</b></p>	<p>Agree with the principle since most institutions have a centralised approach to risk management. Some respondents</p>	<p>See GL 9 on Home-Host.</p>	

	<p>claim that if there's a need to develop stress testing at a lower level it should be up to the institution, not imposed by the regulator.</p> <p>One respondent thinks that stress testing should be supervised by the home supervisor and this should be asserted in the paper. EU countries should also reach an agreement with regulators outside EU because ICAAP and stress testing will be done at the top consolidated level.</p>		
<b>Para 31</b>	<p>For the sake of avoiding wording conflict between para 31 and para 18, a few respondents suggest deleting the word "may" in the first sentence of paragraph 31, as in practice "the way the ICAAP is structured influences the level at which stress tests are performed".</p>	<p>Agree. As ICAAP will certainly influence the level at which stress tests are performed the word "may" can be deleted.</p>	<p>The way the ICAAP is structured influences the level at which stress tests are performed.</p>
<b>Para 33</b>	<p>One respondent thinks it should be clarified that if stress testing is adequately capturing the exposure at group level, there should be no additional testing for the smaller entities.</p> <p>Another one suggests clarifying that centralised stress testing at group level is fully acceptable since the para seems to imply that application is required to legal entity stress testing, as far as larger legal entities are concerned.</p>	<p>Agree that there is no additional stress testing for smaller entities. No need for change.</p> <p>No change.</p> <p>The requirement was considered important, so there was no intention of excluding it, though it was considered not compulsory.</p>	
<b>III.4 Frequency and time horizon of stress testing</b>			

**ST7. The frequency of stress testing should be determined in accordance with the nature of the risks to which the institution is exposed and the types of tests performed.**

<p><b>ST7/Para 34</b></p>	<p>Some respondents request clarification on the CEBS' view of the sentence "lack of external data may not be seen as a sufficient reason to delay stress tests or not perform them at the right frequency".</p> <p>One respondent claims it would be helpful if the regulators could provide banks with time series of estimated parameters which could be used as a reference when data is scarce.</p>	<p>Agree with comment.</p> <p>Clarification by amending last sentence by "delay the implementation of stress tests or not perform them at the right frequency, unless the institution can demonstrate that it has taken reasonable steps to find alternative ways to stress test but there are no alternative ways available. This is, obviously, not in the scope of a principle-based guidance text.</p>	<p>However, as a result of the dialogue (...) reason to delay <b><u>the implementation</u></b> of stress tests or not perform them at the right frequency, <b><u>unless the institution can demonstrate that it has taken reasonable steps to find alternative ways to stress test but there are no alternative ways available.</u></b></p>
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**ST8. Institutions should determine the time horizon of stress testing in accordance with the maturity and liquidity of the positions stressed.**

<p><b>ST8/Para 35</b></p>	<p>One respondent question of what is the most appropriate time horizon for testing of interest rate risk on the banking book.</p> <p>Some respondents claim the principle might be inappropriate since there are numerous hypotheses within the stress testing framework contributing to different time spans and some risks are not related to maturity or liquidity;</p> <p>Other respondents propose to use the expression "defeasance period" to incorporate the idea that the key variable here is the period of time necessary to reduce or remove the risk rather than the holding period itself.</p>	<p>(ii) See CP 11 (IRRBB)</p> <p>Agree with comment. Amend ST 8 by "where applicable".</p> <p>Agree with comment.</p> <p>Amending para. 35 by an example: "(for instance the time it takes to re-balance the portfolio)"</p>	<p>Institutions should determine the time horizon of stress testing in accordance with the maturity and liquidity of the positions stressed <b><u>where applicable.</u></b></p> <p>In general, the appropriateness of the time horizon should be determined depending on whether changes in the underlying portfolio under consideration take a longer time to implement or not <b><u>(for instance the time it takes to re-balance the portfolio).</u></b></p>
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**ST9. Under specific circumstances, supervisors may require institutions to perform ad hoc stress tests at a specific point in time.**

<p><b>ST9/Para 36</b></p>	<p>Some respondents request for reasonability and feasibility of <i>ad hoc</i> tests and ask supervisors to be cautious when interpreting results as they are not comparable among institutions. Furthermore, claim the possibility should only be used in exceptional cases.</p> <p>One respondent asks for the deletion of the principle.</p>	<p>This is subject to the discretion of the competent national supervisory authorities.</p> <p>Disagree with comment.</p> <p>Discussion with the supervisor is open. See last sentence.</p>	
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**III.5 Data quality and IT systems**

**ST10. Institutions should use accurate, complete, appropriate and representative data when stress tests and the IT resources should be commensurate with the complexity of the techniques and the coverage of stress tests performed by institutions.**

<p><b>ST10</b></p>	<p>A few respondents call for this principle's compliance to be assessed in a flexible, realistic and evolutionary way.</p>	<p>See para 5, 6 and 21.</p>	<p><u>Institutions should use appropriate and representative data when performing stress tests (...).</u></p>
<p><b>Para 37</b></p>	<p>Drawing conclusions from the outcome of stress tests performed on a representative sample for the whole portfolio seems inappropriate to some respondents. A few suggested deleting this requirement and allowing stress tests to be conducted on sub-portfolios as an alternative.</p> <p>One respondent argues it is unclear how the representativeness of the sample can be assured.</p>	<p>Agree with comment.</p> <p>Delete last part of the sentence starting with "and to embrace (...)" With respect to representativeness: this is a free option given to the institutions which can capture the whole portfolio in their stress tests.</p> <p>Delete "completeness" and "accuracy". CEBS Guidelines 7 could be taken as a reference for the representativeness issue</p>	<p>Guidance on data appropriateness, quality standards, consistency with accounting data and representativeness,(...) Where stress tests do not capture the whole portfolio, data has to be representative.</p>



<b>Para 38</b>	One respondent suggests the deletion of the words ‘...accurate, complete...’ from ST10. It is not possible to make an assessment of these features of the data as applied to historic and hypothetical scenarios.	Agree with comment. Delete complete and accurate (see amended text on ST10)	
<b>III.6 Role of the management body and senior management; reporting and interpretation of stress testing results</b>			
<b>Para 41</b>	One respondent defends it is neither necessary nor realistic to require the management body or the senior management to be aware of all the technical details of these exercises.	This is expressed in ST11.	
<b>ST12. The management body has the ultimate responsibility for the overall stress testing framework. Where appropriate the management body can delegate certain aspects of this framework to specific risk committees or senior management, keeping the effective oversight.</b>			
<b>ST12</b>	Some respondents propose extending the possibility of delegation to the whole stress testing framework, particularly within large banks.	CEBS considers essential that the management body buys into the stress testing framework. An extensive delegation could have the negative effect that the management body although retaining the ultimate responsibility for the stress testing framework will have no real incentive to deal with matters of stress testing.	
<b>ST13. The stress testing process should be an integral part of an institution’s risk management framework, with clear reporting lines and communication in an understandable format.</b>			
<b>ST13/Para 42</b>	A couple respondents claim principles 12 and 13 are redundant and propose deleting principle 12.	Disagree with comment. These principles are not redundant but rather complementary. Adequate reporting lines (ST13) are essential to ground the responsibility of the management body (ST12).	

**ST14. Where deemed appropriate by the institution, it should take remedial measures or actions considering the level of risk exposure as revealed by stress tests and the objectives and risk tolerances defined by the management body.**

<p><b>Para 43</b></p>	<p>Fifth bullet point: a few respondents ask for assurance that holding an additional capital buffer shall merely constitute a last response.</p> <p>Sixth bullet point: a couple respondents ask for the bullet point clarification as it could be interpreted as meaning that institutions must have a contingency plan available for each scenario.</p>	<p>Agree. For clarification replace “building up an additional buffer of capital” by “reviewing the capital adequacy”.</p> <p>Clarification. Delete last part of the bullet point.</p> <p>More generally, the bullet points are clearly marked as examples and not as mandatory requirements. Clarification by replacing “Examples include:” by “e.g.”</p>	<p>Fifth bullet : <b><u>reviewing the capital adequacy</u></b> sixth bullet : implementing contingency plans</p> <p>§43 : “...These measures (...) circumstances <b>e.g</b> :</p>
<p><b>Para 45</b></p>	<p>One respondent suggests including this para in para 47, in replacement of the fifth indent.</p>	<p>Disagree with comment. See below relative to para 46.</p>	
<p><b>Para 46</b></p>	<p>Another respondent proposes to include para 46 requirements on para 47.</p>	<p>Disagree with comment. Para 46 deals with decisions effectively implemented; while para 47 deals more with the general framework of possible measures or actions.</p>	

**ST15. Appropriate documentation should be in place to facilitate the adequate implementation of the whole stress testing framework.**

<p><b>ST15/Para 47</b></p>	<p>Several respondents propose replacing the current version of paragraph 47 by a</p>	<p>Agree with comment. Replace adding “types of remedial</p>	<p>As indicated in CEBS’s guidelines (...) approved by the</p>
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	<p>more general documentation clause.</p> <p>One respondent proposes the acceptance of delegating the approval of documentation as well.</p>	<p>measures and actions”</p> <p>Agree with comment. Add “or a designated committee thereof”.</p>	<p>management body <b><u>or a designated committee thereof.</u></b> As far as the stress testing process is concerned, <b><u>all material information (e.g. scope of exposure, underlying assumptions, responsibilities, reporting lines and types of remedial measures and actions)</u></b> <b><u>should be appropriately documented.</u></b></p>
<b>III.7 Review and update of stress testing methodology</b>			
<b>ST16. Institutions should consider periodically whether stress tests are still adequate. In particular, institutions should ensure that assumptions regarding the risk profile and the external environment are still valid over time.</b>			
<b>Para 48</b>	<p>Second sentence: Given that the bullet points on this para are not meant to be a checklist, some respondents suggest to change the word ‘should’ in the second sentence to ‘could’.</p> <p>A few respondents also ask to be clarified that a yearly review should not be applied to the process as a whole.</p>	<p>Agree with comment. Replace second sentence by: “In particular, this internal assessment should consider the relevance of the following:”</p> <p>Clarify. Replace “stress testing process” by “stress tests” in first sentence of para. 48.</p>	<p>The institution should conduct an assessment of the adequacy of the <b><u>stress tests</u></b> particularly in the light (...)where the risk profile of the institution changes quickly. <b><u>In particular,</u></b> this internal assessment should <b><u>consider the relevance of the following:</u></b></p>
<b>IV. Stress testing guidelines by risk categories</b>			
<b>Para 49</b>	<p>Proposal to delete para 49 and to connect CP 12 with clear references to other CEBS-guidelines or the CRD on specific topics</p>	<p>Disagree with comment. Para 49 contains some important clarifications and the reference to CP 11.</p>	
<b>IV.1 Macro-economic stress tests</b>			
<b>Para 51</b>	<p>A couple respondents propose to</p>	<p>Disagree with comment.</p>	

	rephrase § 51 as follows: 'Under Annex V Paragraph 2 of the CRD, institutions may manage,' as they argue macro stress tests may not be relevant for all institutions.	Annex V, para 2 of Directive 2006/48/EC says "shall" leaving little room for interpretation.	
<b>ST17. In line with one of the CEBS's High Level Principles listed in the CEBS Guidelines on the Supervisory Review Process *ICAAP 8) institutions should use stress testing as one (among others) tool to assess the risks in a forward looking manner.</b>			
<b>Para 52</b>	Some respondents suggest deleting last 2 sentences as they are already described in GL03, ICAAP 8.	Agree with comment. Delete last two sentences.	Ends up with: "This is because certain strategies may need to be adequately funded by the institution in advance of their implementation. "
<b>IV.2 Market Risk</b>			
<b>IV.2.b Principles for institutions using an internal model for the calculation of their market risk minimum capital requirements</b>			
<b>Para 55</b>	One respondent proposes to delete the examples mentioned due to danger of tick box approach.	Disagree with comment. A "tick box" approach is not intended. Given the state of development of market practices in relation to stress testing on market risks, examples are deemed appropriate and useful for those institutions which are quite unfamiliar with those stress tests.	
<b>ST19. For those institutions using internal models for the calculation of capital requirements for market risks, supervisory requirements for stress testing remain unchanged. Their on-going fulfilment will be considered under the SREP.</b>			
<b>ST19</b>	One respondent recommends to rephrase the principle to incorporate the idea that it is the use of internal models for the calculation of <u>regulatory</u> capital	Agree with comment	For those institutions using internal models for the calculation of <b>regulatory</b> capital requirements (...).

	requirements for market risks		
<b>Para 56</b>	<p>Third bullet point: a few respondents suggest the expression “most severe” to be replaced by the expression “exceptional but plausible” since the former might contradict the requirement of considering only exceptional but plausible events.</p> <p>Fourth bullet point: a few respondents recommend the deletion since it might seem to induce that the bullet aims at introducing a new set of limits under stress conditions</p>	<p>Agree with comment</p> <p>Replace “most severe” by “exceptional but plausible”.</p> <p>Instead replace “must” by “should”. The bullet point doesn’t aim at doing so, although we recognise it could be good practice.</p>	<p>3<sup>rd</sup> bullet: the programme should encompass situations identified by institutions as <b><u>exceptional but plausible</u></b> based on their portfolios’ characteristics.</p> <p>4<sup>th</sup> bullet : institutions should (...) In particular, (...) set by institutions <b><u>should</u></b> be checked against the results of the stress testing calculations.</p>
<b>IV.3.a. Concentration Risk</b>			
<b>Para 60</b>	<p>One respondent proposes to delete the second sentence of this paragraph as is redundant with ST 21.</p> <p>Another one suggests the deletion of third sentence as it only provides an example.</p>	<p>Disagree with comment.</p> <p>No change.</p>	
<b>ST20 Institutions under the large exposures provisions using the comprehensive method for calculation the effects of financial collateral, or permitted to use their own estimates of LGDs and conversion factors, should identify conditions which would adversely affect the realisable value of their financial collateral</b>			
<b>ST20</b>	<p>Some respondents propose to revise ST20 and ST21 in light of the ongoing work on concentration risk and large exposures.</p> <p>A few respondents suggest the removal of “or any other event which may affect</p>	<p>Comments were forwarded to WG on Large Exposures (and to the Workstream on Concentration Risk), paper of which is in process of being revised just now.</p> <p>We keep the text, but commit ourselves to revise it if necessary in due times.</p>	<p>Although the CRD is silent as to the form, such market conditions may include downturn scenarios or other events which may affect the realisation of the collateral's estimated value.</p>

	<p>the realisation (...)” since it might impose that all events may affect the collateral’s value realisation.</p> <p>One respondent proposes to remove principles on concentration risk out of the stress testing paper as they relate to a very specific factor.</p>	<p>Agree with comment.</p> <p>Replace “any other event” by “other events” in para. 61. See amended text on para 61.</p> <p>Disagree with comment.</p>	
<p><b>ST21. According to Article 114 (3) of the CRD, where the results of the stress testing indicate a lower realisable value of collateral, the value of collateral taken into account for the purpose of determining an institution’s LE limits should be adjusted accordingly.</b></p>			
<p><b>ST21</b></p>	<p>Some respondents recommend the deletion of ST21 and the accompanying para 65 and their merger with ST20 as they might induce over collateralisation.</p>	<p>Disagree with comment. Contents of Article 114 of Directive 2006/48/EC. Keep the text, but commit ourselves to revise it if necessary in due times.</p>	
<p><b>IV.3.b. Macro-economic stress tests</b></p>			
<p><b>Para 66</b></p>	<p>A few respondents propose the deletion of all section IV.3.b, as it does not add information as compared to paragraph 51.</p> <p>One respondent underlines the view that performing macro-economic stress tests could prove a particularly burdensome exercise for the smaller credit institutions.</p>	<p>Agree with comment.</p> <p>Delete para 66 and section IV.3.b.</p>	<p>Complete deletion.</p>
<p><b>IV.3.c. Stress testing for IRB institutions</b></p>			
<p><b>Para 69</b></p>	<p>One respondent claims that line 3 seems to imply that stress testing is the only tool to be used to meet the Annex VII</p>	<p>Replace in first sentence “ability to withstand such changes” by “by means of stress testing”, which then</p>	<p>Paragraph 40 of Annex VII Part 4 requires institutions to examine (...)and their “ability to</p>

	part 4 test. It should be changed to: "A tool that could be applied is stress testing".	incorporates the second sentence into the first one.	withstand such changes" <b>by means of</b> stress testing.
<b>Para 70</b>	Several respondents propose the deletion or at least the clarification of para 70 in order to maintain clear that a capital add-on is just one measure, among others, to cope with stress testing results.  Some respondents also want to clarify that available capital resources should not fully cover credit risks for the credit portfolio derived from a particular stress scenario.	Clarify. Insert "amongst other measures".  Clarify. Insert "amongst other measures" in first sentence and delete "fully" before cover credit risks(...)	As for the purpose of paragraph 40, the "ability to withstand such changes" means <b>amongst other measures</b> that the institution's available capital resources cover credit risks for the credit portfolio derived from a particular stress scenario.
<b>Para 71</b>	One respondent argues that the language "by contrast" employed under <b>No. 71</b> gives rise to the impression that the stress test mentioned in Annex VII, Part 4, No. 40 and 41 represents two entirely different procedures. We feel that this is not in line with the regulator's intended ratio legis. Hence, we suggest a corresponding amendment of this provision to reflect the actual ratio legis. Should, however, CEBS see a clear difference between the two procedures then it should be clarified where these differences lie.	CEBS considers CP12 sufficiently clear in that respect: while Annex VII §40 mentions stress tests as a means to assess the overall capital adequacy in case of disruption, §41 aims to assess an institution's ability to continue to meet its capital requirements for credit risks in case of a mild recession scenario. No change of wording.	
<b>Para 77</b>	One respondent proposes the deletion of all the examples as they may seem mandatory to be verified for a capital add-on not be built.	Disagree with comment. As it is clearly stated, these are only examples	

<b>Para 78</b>		Insert "among other measures".	However, under (...) indicates a deficit, <b>among other measures</b> additional capital may be required.
<b>ST25. To come up with a complete view of various risk positions, stress testing of other risk types may be usefully considered to design "alternative liquidity scenarios".</b>			
<b>ST25/Para 87</b>	Several respondents suggest deleting the example on how useful information for liquidity scenarios can be obtained from stress tests on credit risk.	Agree with comment. Delete the example (second sentence)	Some useful (...) or operational risk. Reputation risk might be (...) liquidity disruptions (for instance, an event in a major financial centre).
<b>ST26. Supervisors may perform their own stress tests based on available data in their assessment of liquidity risk under SREP.</b>			
<b>ST26/Para 88</b>	A few respondents ask for clarification that the implementation of these stress tests shall not bring additional costs for institutions. One respondent considers appropriate to discuss these stress tests results with the institution, as part of SREP.	This point is taken on board. CEBS will be cautious towards the possible burden for institutions	
<b>V. Considerations for other risk categories</b>			
<b>Para 89</b>	One respondent considers clarification is needed to guarantee that CP12 does not intent to overcome GL3, ICAAP 9.	Add a footnote in §89 after the sentence "Nethertheless, CEBS'guidelines..." ; as follows "see the second sentence of the ICAAP 9 lit g of the Guidelines on the supervisory review under pillar 2"	Footnote 5: However, see ICAAP 9 lit. g. 2nd sentence of CEBS's guidelines on the application of the supervisory review process.