BANKING STAKEHOLDER GROUP

EBA CP 2017 17

DRAFT GUIDELINES ON INSTITUTION'S STRESS TESTING

COMMENTS

BY THE EBA BANKING STAKEHOLDER GROUP

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Comments to the Consultation Paper

General comments

The BSG supports the overall aim of establishing a greater degree of convergence in the methods and practices applied by institutions in their stress testing. The issue of transparency in methods etc. is however of equally great importance. More transparent stress testing methods have for a number of years been a key priority in the institutions' dialogue with the local NCAs, and it is becoming increasingly important to ensure a level playing field among institutions, especially in the context of stress test results directly affecting capital requirements via Pillar II guidance. This is best achieved through transparency of stress testing methods etc. while still leaving some room for NCAs and institutions to carry out the actual stress tests.

We are still concerned, however, that the proposed guidelines in the CP do not to an adequate extent ensure the proper degree of transparency of methods, models and practices thus leaving room for potential erroneous conclusions if participants stress testing results are evaluated by stakeholders solely on a strict quantitative basis. For example, the lack of disclosure of different rating philosophies (PIT, TTC and hybrids) across participating institutions and hence the impact on institutions' stress testing setup remains a concern in regard to the comparability of stress results. The BSG views this as a challenge which should be addressed.

The CP also reflects the EBA's increasing focus on conduct risk, litigation costs and concentration risk. Furthermore, attention is given to possible interlinkages between solvency and liquidity stress tests. As we acknowledge these potential mechanisms and risks, we would, in the light of IFRS9 implementation both in accounting structures and in institutions' stress testing setups for EBA2018, encourage the EBA to also focus on IFRS9 effects in the stress testing exercise.

The BSG finds that parts of the CP relating to issues of solvency-liquidity loops, second round and feedback effects as well as various risk areas could need clarification on how and to what extent these should be accounted appropriately for. We are concerned that the various risk areas and different measures are not fully separable in practical terms and that increased attention to e.g. conduct and concentration risks will double count risks already well-accommodated by the classical risk framework of credit, market, operational and liquidity risk areas. The potential pro-cyclical effects of IFRS9 should also be assessed carefully.

The concept of "plausibility of scenario" should be better defined distinguishing between "probability of occurrence of the scenario", which is relevant, and "probability of breach", which is relevant for reverse stress testing. In this respect, the possibility to estimate probability distributions by simulative methods based on stochastic processes, such as Monte Carlo simulations, should be explicitly mentioned.

Regarding section 4.6.5, on reverse stress testing, specifically point (97), it is important to note that recovery scenarios are not the core element of recovery plans. The CP should rather focus on recovery options and the overall capacity of the entity. The main reason to include recovery scenarios is to assess if the recovery options are enough to redress a recovery situation.. In this context, business models (centralized vs decentralized) and related resolution strategies (MPE and SPE) need to be taken into consideration.