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2016 EU-wide stress test: Frequently Asked Questions

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## Scope

### **1. Why does the EBA run an EU-wide stress test?**

The EU-wide stress test serves as a common foundation on which national authorities can base their supervisory assessment of banks' resilience to relevant shocks, in order to identify residual areas of uncertainties, as well as appropriate mitigation actions. Moreover, the exercise strengthens market discipline, through the publication of consistent and granular data on a bank by bank level illustrating how balance sheets are affected by common shocks.

### **2. Who is involved?**

The EU-wide stress test is initiated and coordinated by the EBA and undertaken in cooperation with the Competent Authorities (the Single Supervisory Mechanism for the euro area banks), the European Central Bank (ECB), the European Systemic Risk Board (ESRB) and the European Commission (EC). The 2016 exercise covers a sample of 51 banks representing about 70% of EU banks total assets.

### **3. How does it work in practice?**

The EBA develops a common methodology that is applied by all the banks in the sample and checked by supervisors. The EBA also acts as a data hub for the final dissemination of the outcome of the common exercise. Competent Authorities (CAs) are responsible for the quality assurance process and the supervisory reaction function. The EBA supports the CAs' quality assurance process by providing common quality assurance guidelines and EU-wide descriptive statistics on the main risk parameters.

### **4. Will banks undertake an asset quality review ahead of the stress test?**

In 2016, the stress test will not be preceded by a coordinated EU-wide asset quality review (AQR) as it was the case in 2014. However, the assessment of asset quality is regularly undertaken by CAs as part of their supervisory work.

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## Process and roles

### **5. What is the role of the EBA?**

The EBA is responsible for developing and providing CAs with a common methodology to allow them to undertake a rigorous assessment of banks' resilience under stress in a common and comparable way. The ESRB is responsible for designing a common adverse scenario on which the stress test can be run. The EC provides the baseline scenario. The EBA also provides CAs with EU descriptive statistics on risk parameters for the purposes of consistency checks. Furthermore, the EBA acts as a data hub for the final dissemination of the common exercise, thus ensuring transparent and comparable disclosure of banks' results. Finally, the EBA plays a key role in ensuring effective communication and coordination between home and host authorities in the framework of colleges of supervisors.

### **6. What are the roles of national Competent Authorities (CAs) and the Single Supervisory Mechanism?**

CAs, including the Single Supervisory Mechanism for the euro area banks, are responsible for ensuring that banks correctly apply the common methodology developed by the EBA. In particular CAs and the SSM are responsible for assessing the reliability and robustness of banks' assumptions, data, estimates and results.

Furthermore, CAs and the SSM are responsible for the quality assurance process as well as for the resulting supervisory actions.

### **7. What banks will be involved in the stress test?**

The 2016 EU-wide stress test exercise will be carried out on a sample of banks covering about 70% of the EU banking sector, as expressed in terms of total consolidated assets as of end 2014. It will include 51 EU banks from 15 European countries.

### **8. Why has the sample shrunk compared to the 2014 EU-wide stress test and also to the 2015 EU-wide transparency exercise?**

Following a wide ranging exercise in 2014, the EBA decided to focus on a more homogeneous sample of large banks, to ensure greater comparability while ensuring a significant coverage of EU banking assets. The 2016 EU-wide stress test exercise is carried out on a sample of 51 banks covering broadly 70% of the national banking sector in the Eurozone, each non-Eurozone EU Member State and Norway, as expressed in terms of total consolidated assets as of end 2014. To be included in the sample, banks have to have a minimum of EUR 30 bn in assets. This threshold is consistent with the criterion used for inclusion in the sample of banks reporting supervisory reporting data to the EBA, as well as with the SSM definition of a significant institution. Smaller banks not included in the 2016 EU-wide stress test will be tested by their relevant competent authorities as part of the SREP Process.

## Timeline and disclosure

### **9. What is the timeline for the stress test?**

After the launch of the exercise, banks will proceed to estimate the impact of the adverse scenario on banks' balance sheets. Banks' results will be quality assured and challenged by the CAs. This can lead to resubmissions and possible additional iterations. The EBA expects to publish the final results of the 2016 EU-wide stress test by early Q3 2016.

### **10. How will data and results be published?**

The most important aspect of the EBA's common EU-wide exercise is the disclosure of comparable and consistent data and results across the EU. Results will be disclosed on a bank by bank basis and the EBA will act as a data hub for the final dissemination of the outcome of the common exercise. The level of granularity of the data disclosed will be consistent with that of the 2014 EU-wide stress test and 2015 EU-wide transparency exercise. It will include the capital position of banks, risk exposures, and sovereign holdings.

The credibility of the EU-wide stress test rests on transparency. Market participants will be able to determine for themselves how supervisors and banks are dealing with remaining pockets of vulnerability.

## Methodological aspects and scenario

### **11. Why have you moved from a 'pass or fail' stress test to an exercise where no specific capital hurdle is defined?**

The objective of the crisis stress tests was to identify possible capital shortfalls and require immediate recapitalisation actions. As banks have now moved to a more steady-state setting, the aim of the 2016 exercise is rather to assess remaining vulnerabilities and understand the impact of hypothetical adverse market dynamics on banks. Although no hurdle rates or capital thresholds are defined for the purpose of the exercise, CAs will use stress test results as an input to the Supervisory Review and Evaluation Process (SREP). In addition the publication of capital ratios will enable market participants to make their own assessment.

### **12. What are the key methodological changes compared to the previous exercise?**

The building blocks of the common methodology are rather similar to those of the 2014 exercise. Some improvements have been included for both refining the previous methodology, based on prior experience, and addressing new relevant risks. In this regard, a methodology to estimate conduct risk-related losses is now included. Additionally, a more precise treatment of FX lending risk and hedging, together with a refinement of the net interest income (NII) methodology, were also introduced.

**13. How will the EBA ensure consistency between both Eurozone and non-Eurozone countries in the conduct of the exercise?**

The aim of an EU-wide stress test is to assess the resilience of financial institutions across the Single Market to adverse market developments. Consistency in the way the exercise is conducted across the EU is necessary to ensure a rigorous assessment as well as comparability of data. To this end, two elements are crucial: (1) a common methodology and consistently applied constraints, such as a static balance sheet, which will provide market participants and institutions with a common exercise to contrast and compare EU banks under adverse market conditions; (2) a common baseline and adverse macro-economic scenario. In addition, the EBA will provide comparative analysis at the end of the quality assurance process by CAs and bank results will be discussed in the framework of colleges of supervisors involving home and host authorities, as well as the EBA.

**14. What is the scope of consolidation?**

The EU-wide stress test will be conducted on the highest level of consolidation (group level). Subsidiaries of banks in the European Economic Area are excluded given the Single Market perspective of the exercise.

**15. How will the stress test results feed into the SREP process?**

The 2016 EU-wide stress test will be one crucial piece of information in the SREP process in 2016. The results of the stress test will allow CAs to assess banks' ability to meet applicable minimum and additional own funds requirements under the stress conditions against the common scenarios and assumptions. Furthermore, the results of the stress tests will be a solid ground for a discussion with individual banks to better understand relevant management actions and how their capital planning may be affected by the stress and ensure that the banks will be above the applicable capital requirements.

As stated in the EBA Guidelines on common procedures and methodologies for the SREP, CAs are expected to factor the results of the EU-wide Stress test, together with ICAAP and other supervisory stress tests and other assessments into the assessment of banks' adequacy of own funds, and in particular their ability to meet the own funds requirements over the economic cycle. Supervisors have a wide range of tools available which will be applied on a case by case basis.

In order to inform the SREP process, the timeline of the exercise has been brought forward compared to 2014.

**16. How will the stress test results be used for cross border banks?**

The results of the stress test forming a vital part of information for SREP purposes will be discussed within the framework of colleges of supervisors established for cross-border banks. Any measures affecting additional own funds requirements (Pillar 2 requirements) will be jointly agreed by the members of the colleges, as required under the legislation of joint decisions on

institutions-specific prudential requirements. In order to inform the SREP process and the calendar of the joint decisions in 2016, the timeline of the exercise has been brought forward compared to 2014.