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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 ECB-Banking Supervision for the euro area banks), the European Systemic Risk Board (ESRB) and the European Commission (EC). The 2016 exercise covers a sample of 51 banks.

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. Which risks are covered?

The EU-wide stress test is primarily focused on the assessment of the impact of risk drivers on the solvency of banks. Banks are required to stress test the following common set of risks:

- Credit risk, including securitisations;

- Market risk, CCR and CVA;
- Operational risk, including conduct risk.

In addition to the risks listed above, banks are requested to project the effect of the scenarios on NII and to stress P&L and capital items not covered by other risk types.

The risks arising from sovereign exposures are covered in credit risk and in market risk, depending on their accounting treatment.

5. Did banks undertake an asset quality review ahead of the stress test?

In 2016, the stress test is not preceded by a large scale, one-off, coordinated asset quality review (AQR) across the EU. That was undertaken in 2014 and the assessment of asset quality is now regularly undertaken by CAs as part of their supervisory work based on the continuous application of the EBA's definitions of non-performing and forborne exposures.

6. Which banks are involved in the stress test?

The 2016 EU-wide stress test exercise is carried out on a sample of 51 banks from 15 EU and EEA countries (37 from euro area countries and 14 from Denmark, Hungary, Norway, Poland, Sweden and the UK). The participating banks are listed in the annex of the Results Report.

7. 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 from 15 EU and EEA countries. The sample was designed to cover 70% of the banking sector in the Eurozone, each non-Eurozone EU Member State and Norway and, to be included, banks have to have a minimum of EUR 30 bn in assets in terms of total consolidated 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 ECB-Banking Supervision definition of a significant institution. Smaller banks not included in the 2016 EU-wide stress test are tested by their relevant CAs as part of the SREP.

Process and roles

8. 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 European Commission 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.

9. What are the roles of national Competent Authorities (CAs) and the ECB-Banking Supervision?

CAs, including the ECB-Banking Supervision 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.

Absolutely key is the responsibility of CAs for the quality assurance process. This means that they check the preliminary results submitted by banks for conservativeness and challenge those results based on their quantitative and qualitative assessments of the banks. CAs are then also responsible for the resulting supervisory actions.

Timeline and disclosure

10.How are data and results published?

The results are published at 22.00 CEST (21.00 BST) on Friday 29th July after the close of all relevant markets. 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 are disclosed on a bank by bank basis and the EBA acts as a data hub for the final dissemination of the outcome of the common exercise. The level of granularity of the data disclosed is consistent with that of the 2014 EU-wide stress test and 2015 EU-wide transparency exercise. It includes the capital position of banks, risk exposures, and sovereign holdings, among other relevant information.

The credibility of the EU-wide stress test rests also on transparency. The granularity of disclosed information helps market participants understand better the results of the stress test and asses remaining pockets of vulnerability.

11.Will there be any disclosure of actual data for banks not included in the EU-wide stress test?

The EBA has already announced that it will be conducting a Transparency Exercise in December 2016 on a wide sample of over 100 banks. As in 2015, the disclosure will provide actual information on banks' balance sheets based on supervisory reporting data. The data will be published for two reference rates, December 2015 and June 2016 with the aim of keeping a semi-annual time series of data disclosure. The publication of the 2016 EU-wide transparency exercise will accompany the release of the December EBA Risk Assessment Report.

Methodological aspects and scenario

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

The objective of EBA's 2011 and 2014 stress tests were to identify possible capital shortfalls and require immediate recapitalisation actions. However, after five years of continuous capital raising in the EU banking sector, with average CET1 ratios above 13%, the crisis type of stress test appears to be less relevant. Instead of a 'capital now' approach, supervisors will use the results of the stress test to assess banks' forward looking capital planning. Thus, 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 enables market participants to make their own assessments.

13. 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.

14. Does the stress test scenario remain relevant in light of the EU membership referendum in the UK?

The EU-wide stress is based on a general macroeconomic downturn scenario over a 3 year horizon. While the scenario is linked to a specific trigger, the stress impact is driven by the severity of the overall shock over three years. Any given significant shocks will likely cause a recession which would translate into bank losses. Thus, even after the outcome of the EU referendum in the UK, the three year shock remains relevant as an analytical tool to understand what happens to banks' balance sheets if an economic downturn is preceded by an economic shock.

The GDP shock assumed in the scenario for the EU-wide stress test is more severe than the currently available forecasts of the impact of the UK decision.

15. How does 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 provide market participants and institutions with a common exercise to contrast and compare EU banks under adverse market conditions; and (2) a common baseline and adverse macro-economic scenario. In addition, the EBA provides a comparative analysis at the end of the quality assurance process by CAs and bank results are discussed in the framework of colleges of supervisors involving home and host authorities, as well as the EBA.

16.What is the scope of consolidation?

The EU-wide stress test is conducted on the highest level of consolidation (group level). Subsidiaries of banks in the EEA are excluded given the Single Market perspective of the exercise.

17. How do the stress test results feed into the SREP?

The 2016 EU-wide stress test is one crucial piece of information in the SREP process in 2016. The results of the stress test 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 are 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. In practice, this means that supervisors firstly assess any credible management actions and other changes in the bank that would in practice impact the results. Then they assess the potential impact of the stress on the bank over the three year time horizon and decide what the appropriate supervisory response is. Such a response could take the form of dividend restrictions or setting capital guidance which acts as a monitoring metric and not a binding requirement and is not relevant for the determination of the Maximum Distributable Amount (MDA).

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

Please refer to the EBA announcement on 1st July 2016 publishing additional information on how the results of the EU-wide stress test will inform the SREP process:

http://www.eba.europa.eu/-/eba-clarifies-use-of-2016-eu-wide-stress-test-results-in-the-srep-process

The SREP is the key mechanism by which supervisors review the risks not covered, or not fully covered, under Pillar 1 and decide whether capital (and liquidity) resources are adequate. Supervisors can use the SREP to decide that additional Pillar 2 required capital is needed, as a new minimum, where Pillar 1 does not capture the risks adequately.

In addition, supervisors review whether banks are able to meet relevant capital requirements also in adverse economic circumstances. Stress tests are a key component of this latter assessment.

The 2016 stress test deliberately does not include a pass fail threshold to facilitate this incorporation into each banks unique SREP although supervisors may use internal benchmarks.

Competent authorities are expected to take the following steps following the release of the stress test results:

- Competent authorities will discuss the quantitative impact of the stress test with the institution and understand the extent to which credible management actions may offset some of the impact of the adverse scenario. As the EU-wide stress test is conducted on the assumption of a static balance sheet, the assessment may also take into account some natural dynamics in the balance sheet, based on existing strategic and capital planning;

- Competent authorities will assess the net impact of the stress test on the institution's forward looking capital plans and its capacity to meet applicable own funds requirements, although previously published TSCRs may not be directly relevant as they are being updated during 2016;

- A wide range of potential actions may result, including reviewing the TSCR where the stress test reveals an imminent risk to the solvency of the institution; or using the qualitative outcomes to inform the SREP assessments in areas such as risk management; or identifying hidden concentrations. More generally however, authorities may consider the following: (i) requesting changes to the institutions' capital plan (e.g. potential restrictions on dividends) or strategy, (ii) setting capital guidance, above the combined buffer requirement. In cases where capital guidance is provided, that guidance will not be included in calculations of the Maximum Distributable Amount, but competent authorities would expect banks to meet that guidance except when explicitly agreed, for example in severe adverse economic conditions. Competent authorities have remedial tools if an institution refuses to follow such guidance.

18.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.