

The Director General delegate

Paris, March 31<sup>st</sup> 2010

## FBF comments on the revised guidelines on technical aspects of Stress Testing - CEBS Consultation paper CP 32

Dear Sir,

The French Banking Federation (FBF) is the professional body representing over 450 commercial, cooperative and mutual banks operating in France. It includes both French and foreign-based organizations.

The FBF is pleased to contribute to the discussions initiated by the CEBS on the stress testing guidelines (CEBS Consultation paper CP 32). The FBF welcomes the initiative of the CEBS to introduce revised guidelines that will supplement the work that it has already carried out.

The FBF agrees on both the purpose of CP 32 and the principles exposed in the document and considers that these principles are a significant contribution to improve stress testing in the banking industry.

However the FBF notes that the level expected by the supervisors is very ambitious and exceeds by far what is currently performed by banks. Obviously stress testing must comply with the principles of proportionality and realism.

Moreover the FBF notes that the new measures proposed by the Basel Committee and the European Commission to increase the resilience of banks include several provisions under Pillar 1 that meet some of the requirements set out in this consultation paper.

You will find in the attached annex our detailed comments on the proposals.

The French Banking Federation wants to see the instigation of healthy competitive conditions and believes the only way to do is to establish appropriate regulations. The FBF remains at your disposal for any further discussion on these matters.

Yours sincerely,

Pierre de Lauzun

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## FBF detailed comments on the revised guidelines on technical aspects of Stress Testing - CEBS Consultation paper CP 32

The main principles set out in this consultation paper have been favourably received by the French banks. However, they note that the level expected by the supervisors is very ambitious and far exceeds what is currently carried out in the banks. From this viewpoint, the French banks consider that the document describes in detail the best practices that need to be applied in order to perform stress tests but they believe their implementation must comply with the principles of proportionality and realism.

In fact, the variety of stress tests contemplated coupled with the different severity scenarios only serve to increase the calculations and cloud the results thereby preventing the management body from learning the useful lessons of these simulations. It is therefore important to remember that the use of stress tests must comply with the principle of proportionality (paragraph 9). Similarly, assumptions and scenarios should be limited to exceptional but plausible events, in accordance with the recommendations of GL10.

From this viewpoint, the French banks would state that increasing the level of capital is not the unique answer to stress test results and that these should not serve to calculate the size of capital buffers that the regulators envisage to implement in order to deal with the procyclicality of prudential and accounting standards. As indicated in paragraph 24 - GL 3, there are numerous types of corrective measures likely to be introduced by the management body of the institution when it examines the results of the stress tests. In any event, the level of capital required under Pillar 2 cannot be determined from calculations based on scenarios that have not been normalised by the regulators. More generally, stress testing constitute an information tool for the management body to help it in the decision-making process, and do not necessarily lead to corrective measures or an increase in capital requirements.

The French banks note that the new measures proposed by the Basel Committee and the European Commission aiming to increase the resilience of banks include several provisions under Pillar 1 that satisfy some of the requirements set out in this consultation paper. This is the case notably for securitisation, trading book capital requirements with the introduction of the IRC and the counterparty risk with the EPE approach, and resecuritisation. Under these circumstances, we do not think it essential to perform stress tests under Pillar 2 on factors that have already been subject to a capital adequacy assessment under Pillar 1 under stress conditions. Similarly, we do not believe the reputation risk necessitates a stress test if it has been included under the operational risk in Pillar 1, also under stress conditions.

French banks appreciate that reverse stress testing should not result in additional capital requirements (GL 11 paragraph 29). Reverse stress testing is one of the risk management tools at the disposal of the management body. It aims to identify which risk drivers could cause an institution's business model to fail and to prevent it by different measures or actions.

From a practical point of view, institutions note that reverse stress testing could be difficult to perform. In fact it can be extremely difficult to develop a global scenario whereas the institution or group's default would rather result from the combination of a large number of different scenarios relating to specific portfolios on one hand and on specific types of risk on the other hand. It would be quite difficult to maintain consistency between these different scenarios. In addition, to combine probability of occurrence with these scenarios can be extremely sensitive. In such a context, it should be envisaged to perform reverse stress tests by activity in order to appreciate the sustainability of a business line or an entity.

Concerning stress testing methodologies (section 3 of the CP 32), the French banks argue that undertaking stress scenarios combining all risk drivers (credit, market, interest rate, liquidity) and all perimeters (including sophisticated products) is very difficult to perform, because of constraints of coherence between stress factors on credit and market perimeters.

Aggregation of stress scenarios' results via identical confidence interval and time horizon is a first step but is not fully satisfying.

Concerning the scope of application of stress-tests (GL 13), the notion of "firm-wide basis" needs to be clarified to establish whether it relates to a legal entity. Clearly, specific stress tests or sensitivity analyses on, for example, a portfolio can be carried out at entity level. However, stress tests based on scenarios including numerous assumptions must be performed at a consolidated level. From this viewpoint, the French banks believe the college of supervisors should coordinate this work, under the lead of the consolidating supervisor and refrain from asking entities under their control to carry out stress tests that are unlikely to be consistent with those requested at group level (GL 21).

Concerning more specifically recommendations about securitisations proposed in Annex 2, the French banks agree with the CEBS about integration of this kind of exposure in the stress tests. However, due to the huge difficulty to implement these recommendations, it would be justified to modify the timeframe consequently, for example, a minimum of 18 months period could be granted or, failing that, the CEBS would expressly decide a progressive implementation. Furthermore, concerning warehousing operations, their inclusion in securitisations 'stress tests is questionable for two reasons : (i) these exposures are already included in general stress IRB with capital add-on, and (ii) as long as the securitisations'structure is not fully completed, calculations are subject to numerous uncertainties. Lastly, the inclusion of pipeline risks seems not necessary as far as (i) the probability of completing the closing of the transaction is not taken into account and (ii) in period of stress the number of transactions arranged for third parties which are financed is quite limited.

Finally, the proposed timetable for the implementation of these guidelines, which provides for application as from 30 June 2010, appears to be much too ambitious. Admittedly, the CEBS states that these guidelines can be implemented gradually. However, it is likely that the belated publication of these guidelines will not allow supervisors to coordinate their actions and establish, at group level, the factors and stress scenarios to be explored.