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2014 EU-wide stress test: Frequently Asked Questions

Process and scope

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

The EU wide exercise serves as a common foundation on which national authorities can base their supervisory assessment of banks' resilience to relevant shocks, in order to identify appropriate mitigating actions. It should be noted that the EU-wide stress test is a complement and not a substitute to other supervisory stress tests conducted at domestic level.

Moreover, the exercise strengthens market discipline, through the production of consistent and granular data on a bank by bank level illustrating how balance sheets are affected by common shocks.

- **Who is involved in the EU-wide stress test?**

The EU-wide stress test is initiated and coordinated by the EBA and undertaken in coordination with national supervisory authorities, the European Central Bank (ECB), the European Systemic Risk Board (ESRB) and the European Commission (EC). This exercise is conducted by all competent authorities across the EU on a sample of banks covering at least 50% of the national banking sector in each EU Member State.

- **What is exactly the responsibility of the EBA in this process?**

The EBA is responsible for developing and providing competent authorities (CAs) with a consistent and comparable methodology to allow them to undertake a rigorous assessment of banks' resilience under stress. The ESRB will provide a common scenario on which the stress test can be run. The EBA will also provide CAs with EU benchmarks on risk parameters for the purposes of consistency checks. Furthermore, the EBA will act as a data hub for the final dissemination of the common exercise, thus ensuring transparent and comparable disclosure of banks' results. Finally, the EBA will play a key role in ensuring effective communication and coordination between home and host authorities in the framework of colleges of supervisors.

- **What is the responsibility of Competent Authorities?**

CAs are responsible for ensuring that banks correctly apply the common methodology developed by the EBA. In particular CAs are responsible for assessing the reliability and robustness of banks' assumptions, data, estimates and results. In addition, CAs and, for euro-area countries, the ECB are in charge of quality assurance and therefore of challenging banks' results and ultimately of determining and taking any supervisory action needed.

- **What is the timeline for the stress test?**

The 2014 EU-wide stress test is expected to be launched in May 2014. By that date the EBA will communicate the final methodology, adverse scenario and templates to be used by the banks involved in the exercise. The EBA expects to publish the final results of the 2014 EU-wide stress test in October 2014. The timeline has been agreed and coordinated with the ECB and is, therefore, in line with the overall timeline of the Single Supervisory Mechanism (SSM) Comprehensive Balance Sheet Assessment.

- **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. This also explains the difference between the SSM sample, which includes subsidiaries, and the EBA sample.

- **What is the sample for the 2014 EU-wide stress test?**

The 2014 EU-wide stress test exercise will be carried out on a sample of banks covering at least 50% of the national banking sectors in each EU Member State, as expressed in terms of total consolidated assets as of end of 2013. It will include 124 EU banks from 22 EU Member States.

- **What definition of capital will be used?**

The impact of the EU-wide stress test will be assessed in terms of Common Equity Tier 1 (CET1) as defined in the Capital Requirements Regulation (CRR)/Capital Requirements Directive with transitional arrangements as per December 2014, December 2015, and December 2016.

- **What will be the treatment of banks' sovereign assets?**

The scenarios will affect the price of all sovereign security positions. Those securities held in the trading book will be subject to mark to market with losses realised immediately. Those sovereign assets held as hold to maturity will be subject to a shift in the risk weights based on internal model assessments of changes in credit risk. The treatment of securities that are held as available for sale are marked to market too, but the capital impact will depend on choices made by supervisors. In the legal framework competent authorities have the discretion, as per the CRR/CRD4, to filter out unrealised losses. Either choice will be clear in the transparency of the results.

- **How will the additional national sensitivities work?**

To enhance the relevance of the shocks for the specific jurisdictions and contribute to a better understanding of idiosyncratic risks in banks a CA can apply system specific shocks on-top of the common EU-wide scenario. National sensitivities might for instance encompass other hypothetical interest rate scenarios or shocks in geographies or sectors of high importance for the national system. However, to ensure comparability the EBA will disclose the results on basis of the common scenarios, while results stemming from those additional sensitivities will be shown separately by CAs. Similarly a CA can apply additional thresholds such as fully

phased-in Basel 3 capital ratios, but also presented separately from the common EU wide exercise.

▪ **How will the EU-wide stress test interact with Asset Quality Reviews (AQRs)?**

AQRs are a prerequisite for stress tests since they ensure the reliability of the starting point. The EBA issued a recommendation on asset quality reviews to contribute to a more uniform approach in competent authorities' evaluations of banks' credit portfolios but CAs are responsible for determining the modalities of the AQR. The AQR should include risk classification and provisioning and support sufficiently prudent capital levels and provisions to cover the risks associated with these exposures. AQR results should inform the starting point for the stress test.

▪ **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 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 competent authorities and bank results will be discussed in the framework of colleges of supervisors involving home and host authorities, as well as the EBA.

▪ **Is it planned to publish data and results?**

The most important aspect of the EBA's common EU-wide exercise will be 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 for the final dissemination of the outcome of the common exercise. The level of granularity of the data disclosed will be at least consistent with that of the 2011 EU-wide stress test and 2013 EU-wide Transparency Exercise. It will include the capital position of banks, risk exposures and sovereign holdings.