

## Efficient Stress Testing: the need for a global code of practices

Matthew Preston, head of Planning and Delivery, Stress Testing, HSBC

It is important to have a well-designed framework. HSBC prepared the Stress testing during 6 months to 1 year, to build up global operating models. IT, Risk, Finance were implicated in the process.

HSBC defined a stress Test Cycle as follows: Scenario Analysis, B/S, P&L and RWA projections, Capital Impacts and Management Actions, lessons learned, operating model definition and readiness. Main issue was the data submission requirements by EBA which introduce operational challenges.

Modelling approaches and methodology combined granular bottom up approach (calculation) depending on proportionality and top down projections.

Stress testing provides tools to give insights on risks to capital and liquidity. However a big issue is how Stress Testing can capture non-financial risks such as climate change, social risk...

Marc Irubetagoiena, Head of Group Stress testing and Financial Synthesis, BNP Paribas, points out to keep a proper governance between local and global, and underlines that the Stress testing approach should be proportional.

Mario Quagliariello, Director of Economic Analysis and Statistics, EBA

He presents the methodological key features and the impact on EU aggregate CET1 ratio. He indicates that banks had a lot of concerns regarding the impact on profitability and risk. Main drivers are credit risk losses which have the highest impact, before market and operational losses.

He estimates the exercise is severe because of the severity of the scenario and IFRS implementation. There a lot of assumptions and results depending on the model, and he admits some template were difficult to obtain. The challenge was to find the right balance between what we can do and what we can't do. New Stress tests are planned in 2022 and banks will have more time to prepare.

Globally EU banks proved to be resilient.

Anne-Sophie Borie-Tessier, Directeur Adjoint, Direction des Etudes & Analyses des Risques, ACPR

Anne-Sophie points out many issues on the road map. There are a large range of stress tests with macro and micro-prudential perspectives at different levels (national, EU/SSM and international FSAP programs).

Major issues: Banks and Supervisors have different views regarding the objectives, transparency of the



results, expectation to have more information, cost of the execution of the stress test, level playing field consideration, granular data to be collected (methodological).

She points out the specificity of the French banking sector with Credit Logement with lower risk impact regarding the housing loan market, and the non-remuneration of sight deposits.

Olivier Caillat of Société Générale as participant, observes that SG changed his revenues since 2008, revenues are more clients sourced. A major issue is the treatment of deposits, not only in France, and the impact on NSFR calculation, between stable and non-stable deposits

Rami Feghali, Partner, PWC

He estimates there is a kind of mismatch between banks and regulators. Stress testing is a regulatory requirement but not a binding capital constraint in Europe. Internal stress tests are not Economic capital requirement. Stress tests are beauty contest, the binding constraint for capital management is regulatory capital. Issue relative to the black box: if you put too much equation in the model, people don't understand and give up.

Stress tests can be used as an indicator to define differentiated capital buffer allocations, embedded in main processes including risk appetite and budget process. Key factors: data, methodology, uncertainty.

Antoine Weckx, Oliver Wyman Financial Services, Javier Garcia, Oliver Wyman Madrid

Stress tests are valuable because they give results and confidence in the Banking sector. But they are difficult to produce, involve a lot of people and require big budgets. The issue is what's the value for the effort? By the way low impact on the Stock exchange value.

How to improve the value for effort equation? different proposals such as reasserting the bottom up nature of the exercise, adjusting the methodology, working on process simplification and calendar, recommitting to Stress testing as a key transparency and risk management tool with clear linkages to capital requirements, requires industrialization, both at bank and supervisory level.

A call for action is needed to prepare the EBA 2020 exercise.

5 leads identified: re-evaluate the bottom up exercises, with a better calibration, work on the methodologies, process and calendar to be much smoother, more transparency from the supervisor (what is expected?), and more automotive production because of costs.

Industrialisation is a key agenda theme, such for templates, to make banks task easiest. Try to find a balance between supervisory expectation and industry dream.