



EUROPEAN CENTRAL BANK

BANKING SUPERVISION

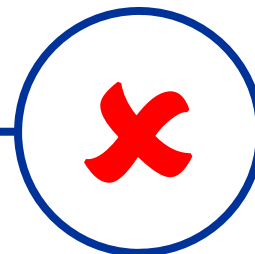
Update on 2018 stress test exercises and 2019 supervisory priorities

November 2018

Overview of topics to be covered/not covered in this **presentation**



- **Recap** of **structure, objective** and **scenario** of stress test 2018
- **Update** on **current status** and **details** of upcoming **publication**
- **Information** on **integration** of **stress test results** in the **Supervisory Review and Evaluation Processes (SREP)**
- **SSM Risk Map 2019** and overview of the **SSM 2019 Supervisory Priorities**



- **Disclosure** or **discussion** of **final results**
- **Discussion** of individual **bank performance** or **implications** of **stress test results**
- **Discussion** of **methodological questions** or of **specific benchmarks/models**

Agenda

1 Stress Test 2018

1.1 Key takeaways from the 2018 Stress Test

1.2 Background information

1.3 Methodology

1.4 Challenger views and stress test timeline

2 Integration of stress test results into the SREP

3 Overall next steps for the stress test and the SREP

4 SSM risk map and supervisory priorities 2019

1.1 Key takeaways

Key takeaways of the stress test exercise

- ✓ ECB Banking Supervision performed two supervisory stress test exercises for significant institutions in 2018.
- ✓ Stress test exercises lasted from January to October with more than 200 people involved from ECB, NCAs and NCBs. The longer timeline facilitated including the implications of the introduction of IFRS 9 at the beginning of 2018.
- ✓ ECB followed a fair and tough quality assurance approach throughout the exercise, supported for the first time by the dedicated Stress Test Account Reporting (STAR) IT infrastructure.
- ✓ EBA will publish results on 02 November at 17:00 UK time (18:00 CET) – aggregate report of overall results and bank individual results.
- ✓ The results will be one of the important inputs in the 2018 Supervisory Review and Evaluation Process (SREP) and composed of a Pillar 2 Requirement (P2R) and a Pillar 2 Guidance (P2G).
- ✓ Stress test results will be primarily reflected in P2G (quantitative results) but can also impact P2R (qualitative results) – adverse stress test results will not affect the MDA trigger.

1.2 Background information

ECB/SSM performed two supervisory stress test exercises for significant institutions (SIs) in 2018



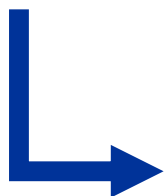
EU-wide EBA stress test

- **33** SSM SIs¹
- **4** Greek banks underwent the same stress test under the EBA scenario and methodology
- **Publication** of results
- EU-wide exercise under **EBA coordination**, in cooperation with ESRB, ECB and NCAs



SSM SREP stress test

- ~60 other SSM SIs¹
- Under **ECB/SSM coordination**
- **EBA methodology applies** with reduced complexity (i.e. proportionality)



Objectives

- Assess the **resilience of financial institutions** to adverse market developments.
- **Contribute to the overall Supervisory Review and Evaluation Process (SREP)** to ensure institutions' capital and liquidity adequacy, as well as sound risk coverage and internal processes.
- Ensure a **consistent treatment** of all SSM SIs.



The results of both exercises will feed into the SSM SREP

¹ Combined number of SIs included in EBA and SSM SREP stress test samples does not equal total number of SIs under SSM supervision, as some exceptions apply (e.g. banks that were subject to a comprehensive assessment in 2017 or will be in 2018; or SIs that are subsidiaries of other SSM SIs, already covered at the highest level of consolidation).

1.2 Background information

Scenario comparison to 2016 and 2014 – 2018 exercise toughest scenario so far

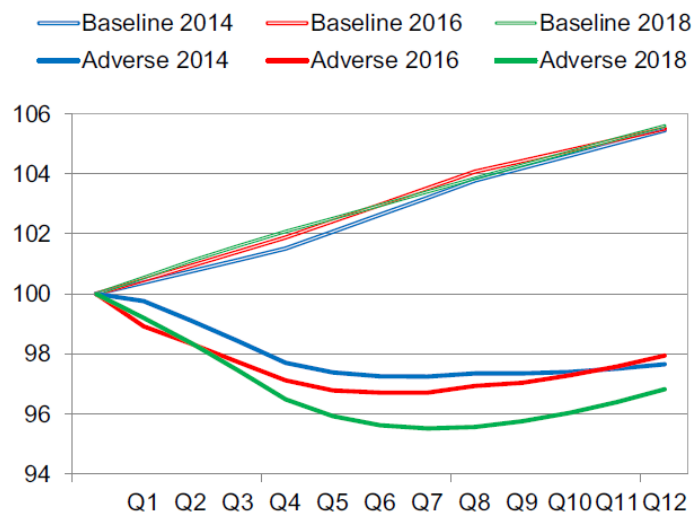
- 2018 ST scenario the **most severe out of all EU-wide ST exercises** so far
- The EBA adverse scenario of the ST 2018 is **significantly more severe** than the market analysts' **estimates of impact of the “Brexit”** on the euro area economies

EU Real GDP deviation from baseline: 2018, 2016 and 2014 EBA stress tests (percentage points)



Source: European Systemic Risk Board

EU real GDP level: 2014, 2016 and 2018 EBA stress tests

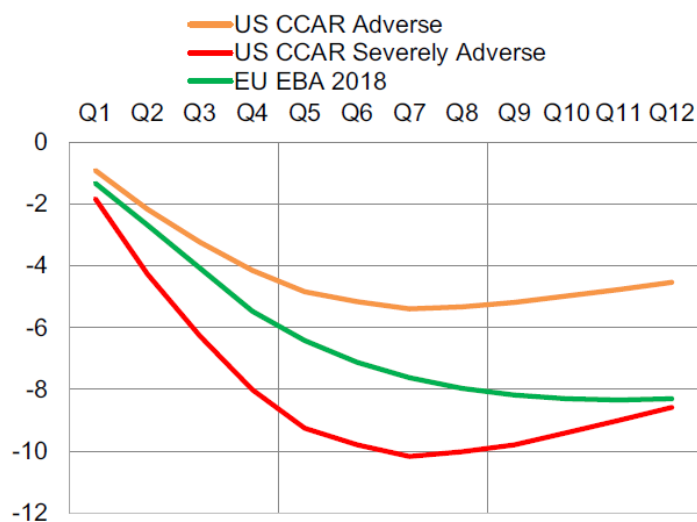


1.2 Background information

EU stress test scenario between CCAR Adverse and CCAR severely adverse

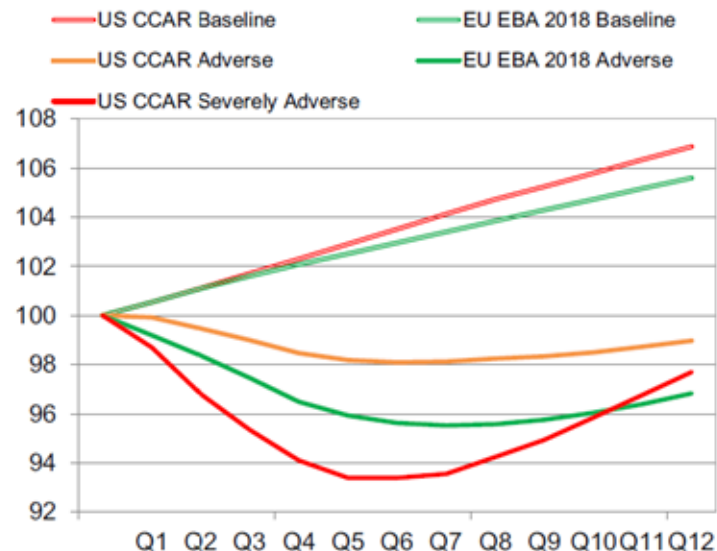
- The severity of the scenario is broadly **comparable** to the one of other **ST exercises (CCAR)**

Real GDP deviation from baseline:
EBA 2018 and CCAR stress tests
(percentage points)



Source: European Systemic Risk Board

Real GDP level: EBA 2018 and
CCAR stress tests



1.3 Methodology

This year's methodology is based on IFRS 9 and is more risk sensitive than in the 2016 Stress Test

Key changes in stress test methodology versus 2016

Credit risk	<ul style="list-style-type: none">• Reflects IFRS 9 accounting standard under harmonising assumptions (e.g. stage definition and migration, risk-parameter evolution beyond scenario)
Net interest income	<ul style="list-style-type: none">• More realistic constraints e.g. revised restrictions on interest income.
Market risk	<ul style="list-style-type: none">• New specific stress on level 2 and level 3 instruments
Conduct risk and other operational risk	<ul style="list-style-type: none">• Increased consistency by taking into account past losses more widely
Other P&L and capital	<ul style="list-style-type: none">• More granular data to better account for banks' specificities

1.3 Methodology

The IFRS 9 introduction had key implications for the 2018 stress test

- The introduction of IFRS 9 posed a key challenge for the 2018 EU-wide stress test with profound implications for the timeline, methodology and results.
- **The adjusted overall timeline of the 2018 EU-wide stress test by the EBA** allowed banks to meet the challenges of conducting the stress test and applying IFRS 9 for the first time.
- The stress test disclosure will show the **effect of the IFRS 9 restatement on banks' capital position due on 1 January 2018**. In addition, the scenario projections also provide insights into the behaviour of European banks' credit exposures in a downturn situation under the new IFRS 9 accounting standard.
- **Capital ratios are projected both on a IFRS 9 fully-loaded and a transitional basis**. For the latter, banks apply transitional arrangements as per the agreed regulatory approach.

1.4 Challenger views and timeline

Stress test quality assurance – Challenging bank submissions from four distinct perspectives

Perspective

Methodology -adjusted view

- Assessment of compliance of banks' submissions with quantitative restrictions in the methodology: assess impact when replacing bank parameters with compliant parameters

Top-down view

- Comparison of banks' projections against Top-Down models: assess impact when replacing bank parameter values with Top-Down benchmarks (conditional on a given scenario, using bank-specific reference data as a starting point)

Horizontal bottom-up / country view

- Comparison of banks' projections against peers: assess impact when replacing bank parameter values with peer benchmarks
- Horizontal assessment of the data of banks from the same country and across the euro area

Bank view

- Detailed assessment of individual banks' data
- Takes into account bank-specific characteristics

1.4 Challenger views and timeline

Stress test 2018 – A bottom-up exercise in three cycles with a fair and tough quality assurance

Bank-led stress test

February – May 2018

- **Advance data collection**
- **Pre-validation** of templates and submission of bank-led stress test results
- Banks are asked to provide an explanatory note accompanying their submissions

Quality assurance (QA) in three cycles

May – October 2018

- ECB identifies issues from **different QA perspectives**
- Banks receive reports and are asked to “comply or explain” and in the last cycle to “comply”
- QA follows an integrated process in **three submission cycles**

Finalisation of ST results

October – November 2018

- **Publication of results** for EBA banks on **02 November**

1.4 Challenger views and timeline

Information provided by EBA will allow a very detailed view on aggregate and individual results

In line with previous exercises, EBA upon publication on 2 November will provide a **wide array of information** on **aggregate** as well as **individual bank results**, consisting of:

- 1 Aggregate report on overall results**
 - Impact on capital ratios
 - Impact on capital, profitability, risk exposure and leverage
 - Impact by risk type
- 2 Analytical tools**
- 3 Individual bank results on a transitional and fully-loaded basis**
- 4 Full data set**

The information provides a **high level of transparency** and **allows detailed analysis of the stress test outcome** for both scenarios, bank by bank, and country by country.

The image shows a stack of four screenshots from EBA stress test reports. The top-most screenshot is titled 'EU-wide Stress Test: Credit risk STA'. Below it is 'EU-wide Stress Test - P&L', followed by 'EU-wide Stress Test - Risk exposure amounts'. The bottom-most screenshot is 'EU-wide Stress Test: Summary', which contains a table with the following structure:

	Actual Starting point	Baseline Scenario	Adverse Scenario
Calculated by: Net realisable value	380000	380000	380000
Calculated by: Sum of 1 (losses on financial assets and liabilities held for trading or designated at fair value through profit/loss) and			
Calculated by: Depreciation or impairment of financial assets not measured at fair value through profit or loss			
Calculated by: Profit or loss for the year			
Components: Other items			
Common Equity Tier 1 ratio			
Total risk exposure amount			
Common Equity Tier 1 ratio, %			
Fully loaded Common Equity Tier 1 ratio, %			
Capex			
Total foreign risk exposure			
Coverage ratio, %			
Fully loaded coverage ratio, %			
Non-eligible items			
Total amount of instruments with mandatory conversion into ordinary shares upon a final date in the 2018-2019 period (contingible conversion)			
Total Additional Tier 1 (contingible) eligible as regulatory capital under the CRR provisions that convert into Common Equity Tier 1 in an event of a going concern event			
Eligible eligible instruments (contingible) under CRR1 capital under the adverse scenario			

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2. Integration of stress test results into the SREP

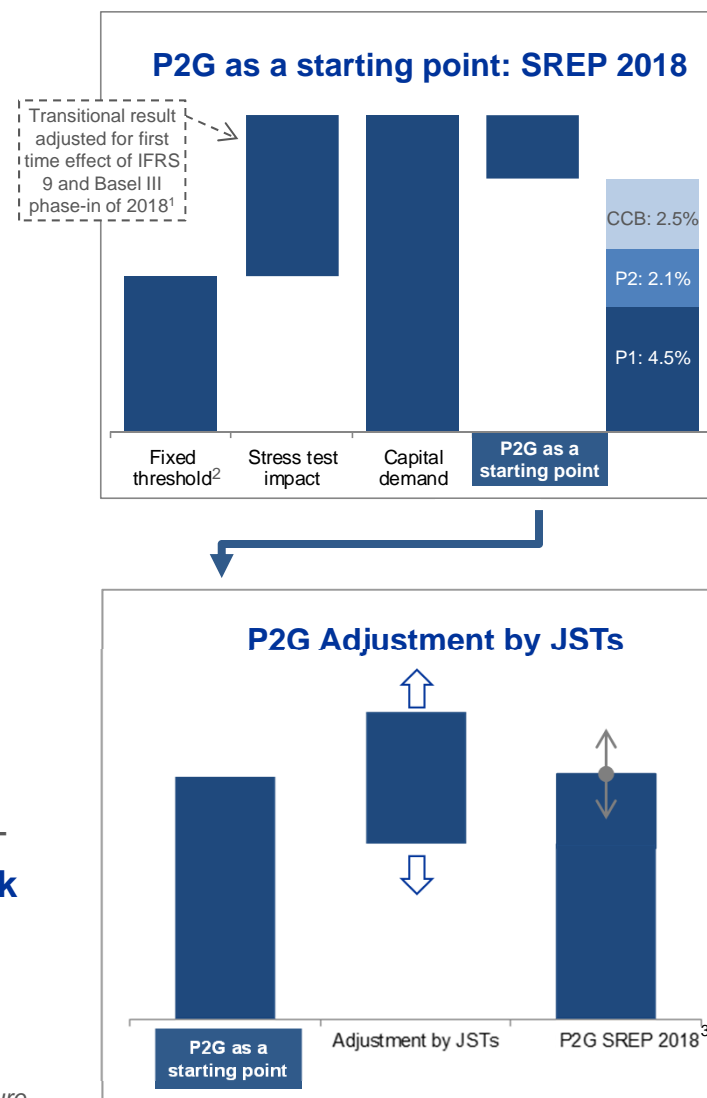
Continuity with the 2016 methodology

- **Qualitative outcome** of the Stress Test will be **included in the determination of the P2R**, especially in the element of risk governance;
- The **stress test is not a pass/fail exercise**
- When setting P2G different elements are taken into account in a **holistic view**, for example:
 - The starting point for setting the P2G is in general the **depletion of capital** in the hypothetical **adverse scenario (quantitative outcome)**;
 - JST take the **specific risk profile** of the individual institution and its **sensitivity towards the stress scenarios into account**;
 - **Also, interim changes in its risk profile** since the cut-off date (31.12.2017) and **measures taken by the bank** to mitigate risk sensitivities such as relevant sale of assets etc. are considered

¹ As these effects cannot happen in the future again

² CET1 ratio of 5.5% + G-SII Buffer if applicable

³ Irrespective of the phasing-in of the CCB, banks should also expect to have positive P2G in the future.



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3. Overall Next Steps

Upcoming key milestones

Key milestones

Timeline

Publication of results on EBA webpages

2 November 2018

Supervisory dialogue

November 2018

2018 SREP Decisions

January 2019

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4. SSM Risk Map and Supervisory Priorities 2019

Outlook on 2019 – SSM Supervisory Priorities

- Each year the SSM defines the annual SSM Risk Assessment, launched in the first quarter of each year.
- Based on this assessment, the SSM Supervisory Priorities are defined and then approved by the Supervisory Board.
- The annual Risk Assessment and the Supervisory Priorities for 2019 are available on the website of European Banking Supervision:

Link to SSM Risk Assessment:

https://www.bankingsupervision.europa.eu/banking/priorities/risk_assessment/html/index.en.html

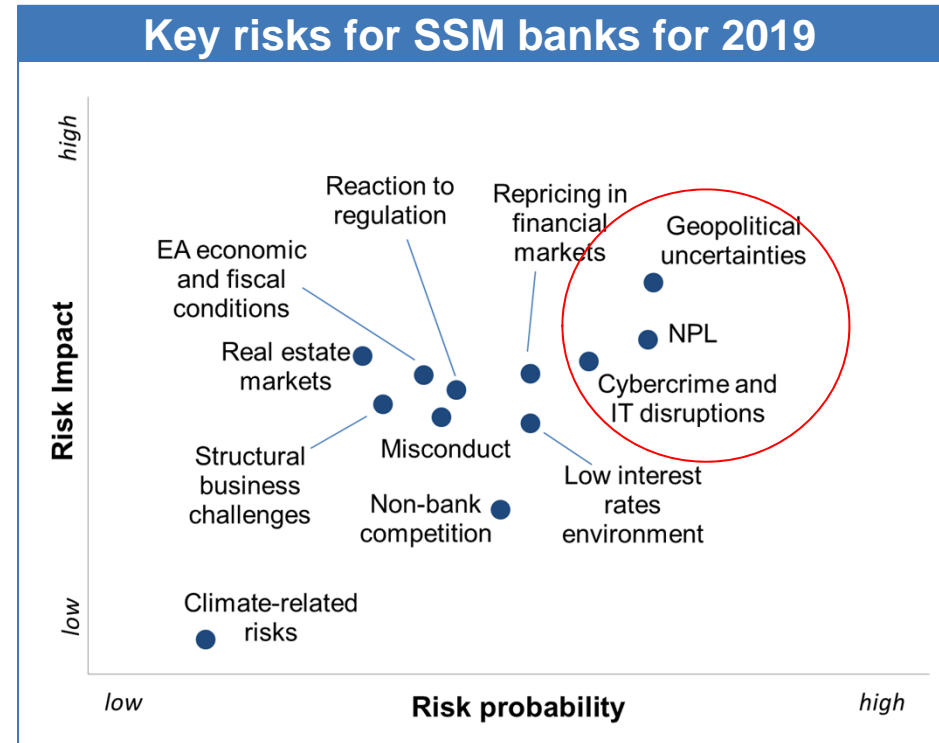
Link to SSM Supervisory Priorities 2019:

<https://www.bankingsupervision.europa.eu/banking/priorities/html/index.en.html>

4. SSM Risk Map and Supervisory Priorities 2019

SSM Risk Map highlights geopolitical uncertainties, NPL and cybercrime & IT disruptions as top three risks

- **Geopolitical uncertainties** and risks of **repricing in financial markets** have increased.
- Political uncertainty around **Brexit** continues and creates a number of challenges, including business and contract continuity risks.
- Euro area banks made significant progress with **NPL** reduction over the past years, however aggregate level of NPLs remains elevated by international standards.
- Ongoing search for yield along with still subdued profitability might result in an excessive risk taking and **future NPLs**.
- Progressing digitalisation requires banks to continue efforts to modernise their infrastructure to shield against **cybercrime and IT disruptions**.

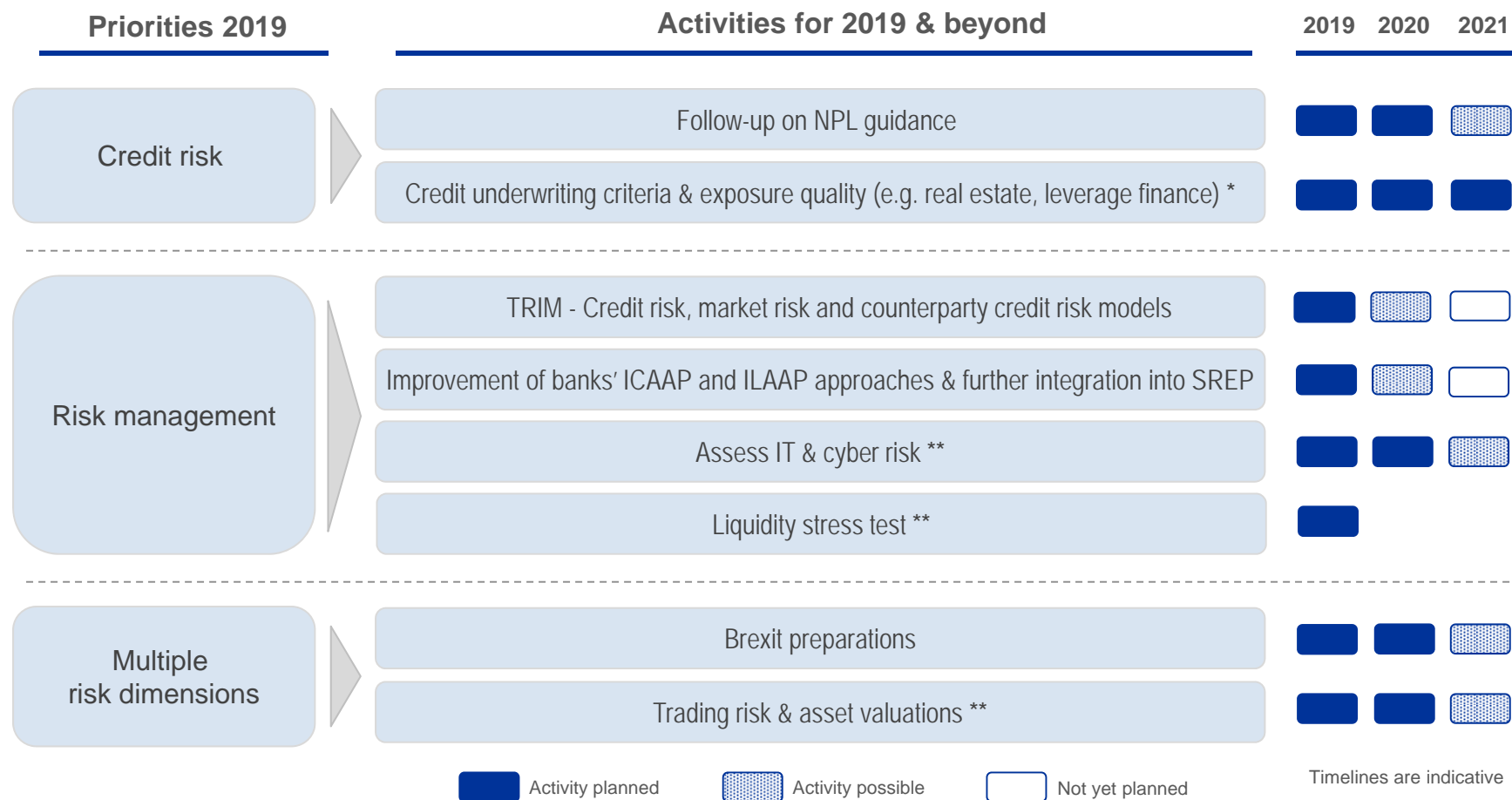


Source: ECB and NCAs.

Note: Risks are not independent and might trigger or reinforce each other.

4. SSM Risk Map and Supervisory Priorities 2019

The SSM Priorities will guide banking supervision in 2019 and beyond



* Amended activity

** New activity in 2019