EBA 2020 EU-wide Stress Test
Market Risk

Methodological differences between 2018 and 2020 exercises

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Agenda

The aim of the EBA EU-wide Stress Test is to assess the resilience of EU Banks to adverse market developments

The methodology regarding Market Risk can be summarized as follows:

- The impact of market risk on all positions at partial or full fair value measurement is to be assessed through **full revaluation**
- The full revaluation is performed after the **application of the shocks**, that are provided from the EBA in the **market risk adverse scenario**, to a common set of market risk factors
- Under the **trading exemption**, Banks are allowed to not apply a full revaluation on items held with a trading intent and their related hedges. Banks under this exemption have the possibility to adopt a simplified set of rules that are based on a sensitivity approach
- After the full revaluation, Banks have to recalculate the **CVA** and **liquidity reserve**
- For **CCR**, it is assumed that the **two most vulnerable** of the largest ten **counterparties** default

With respect to the methodology adopted in 2018, the methodological draft for the EBA 2020 exercise does not show substantial differences

02 Main Changes (1/2)

2020 methodology is characterized by three relevant changes with respect to the 2018 version, but just one can be considered really challenging for Banks

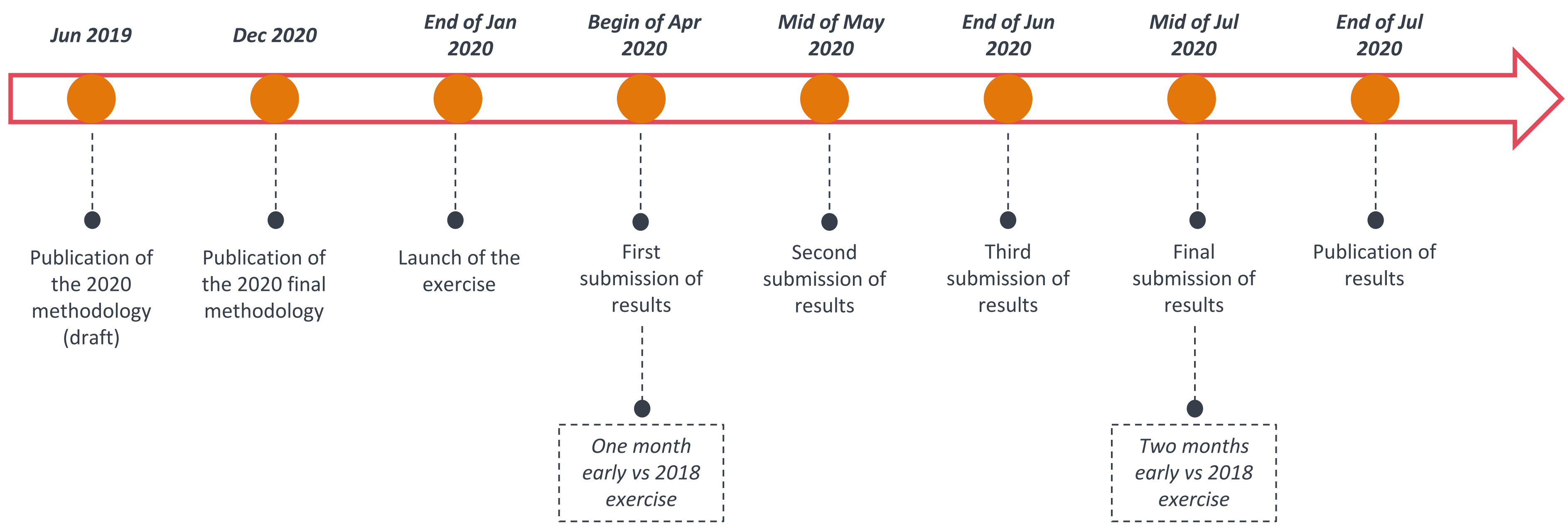
	Relevant Change	***Impact***
1	**The impact of FX risk on positions at amortised cost that are not part of hedge accounting is no more included in the scope of the exercise** ▪ In the 2018 final version of the methodology FX risk on banking book positions was already excluded from the scope of the exercise, no relevant change for Banks	
2	**Positions associated to items held with a trading intent, and their related hedges, cannot be netted before the evaluation of the stress's impact** ▪ The market risk factors that are associated to the hedged position and to the instrument used for hedging are shocked and in a second step the revaluation is performed, no relevant change for Banks	
3	**The EBA is considering to apply a different cut-off date for the market risk methodology to be selected between Sept and Dec 2019 to be announced at the launch of the exercise.** This change may imply a challenge for Banks, as not all business dates have the same level of **data quality** and **monitoring** Possible remediations: ▪ Banks should suggest to EBA an End-Of-Month (EOM) as the **cut-off date**, since usually data are more monitored during those periods and then reliable ▪ Banks should develop a sound Data Governance framework in order to: ○ Develop a consistent **risk factor mapping** using EBA's attributes ○ Implement a **daily monitoring** of data (in terms of *trade data*, *market data* and *credit data*) ○ Undertake **quick remediation actions** (when necessary)	

02 Main Changes (2/2)

In addition to the methodological differences, there are also two relevant changes in the Market Risk Full Revaluation Template (with respect to the 2018 version) that may generate impacts in current Banks' infrastructure

	Relevant Changes	***Impact***
1	**The split between cleared and not cleared level 2 positions for Notional Exposure, Fair Value and P&L** ▪ In the 2018 final version this split was not required. However, Banks should have no problems to cluster their cleared or not cleared positions as it is just a matter of contractual classification of trades	
2	**In the "Breakdown by risk factors" a further drill-down, about the sensitivity type, is required** ▪ The 2020 Market Risk Full Revaluation Template calls for the partition, for each asset class, into their sensitivity type. In particular: ○ **Interest Rates** and **Equity** should be divided into Delta, Vega, Gamma and residual sensitivities ○ **Fx**, **Funds**, **Commodities** and **Credit Spreads** should be divided into Delta and residual sensitivities **This requirement does not represent a serious concern for systemic banks but it might involve some implications for smaller players**. The computation of second order sensitivities, such as Gamma, requires a computational effort that small banks may not be willing to undertake mainly for two reasons: ▪ **Technical difficulties** in the design of the computational tool ▪ **Lack of economic incentives** as the exposure of this kind of institutions to non linear payoffs is usually very limited	

03 Timeline



The anticipation of some of the deadlines with respect to the 2018's timeline might represent a challenge for banks

The reduction of the time to get ready for the submission of the results represents a challenge and there is the need to test the process for conducting the exercise and the governance for decision making in order to ensure a fluid and streamlined process. In order to anticipate this necessity banks should:

- Identify any relevant positions that drive significant **impact on CET 1** under the stress scenario
- Test any relevant **methodological enhancement** in order estimate in advance the impact on the bank's portfolio
- Perform a **test of the overall process** for conducting the exercise

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