

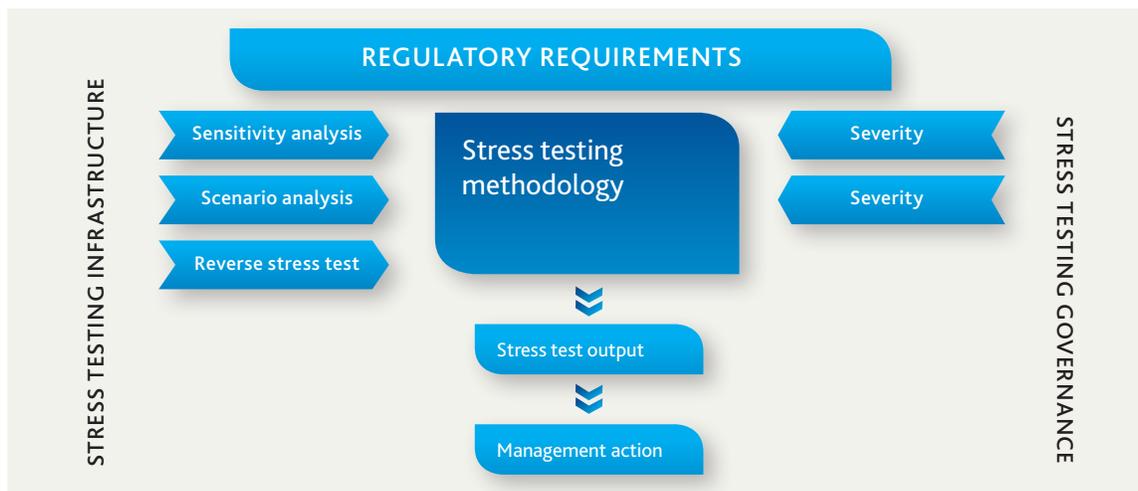
Stress testing regulations

- » Define plausible stress scenarios
- » Calculate capital and liquidity requirements under stressed conditions
- » Define, document and report risk appetite framework to regulators

Increased stress-testing requirements are a regulatory response to the recent financial crisis. The Basel Committee on Banking Supervision (BCBS) introduced stronger stress-testing guidelines in 2009 with the objective of ensuring firms are able to meet capital and liquidity needs under stressed conditions.

Under these new guidelines, banks are required to define and implement both in-house stress scenarios and regulator-defined stress scenarios which are severe but plausible in nature. Regulators also impose system-wide stress-testing exercises as part of their systemic analysis. There is increased emphasis on senior management engagement in order to ensure the results of stress tests are well understood and incorporated in business management.

Example of stress-testing framework: UK FSA 2010 guidelines



The most prescriptive local regulations can be found in the UK. EU countries have been issued with guidelines by the EBA (European Banking Authority) to incorporate into their national regulation. Stress-testing guidelines are enhancements to Pillar 2 (ICAAP) and have been mostly incorporated in Basel III. High level stress-testing requirements can also be found in the Dodd-Frank Act in the United States.

It is now widely recognized that beyond complying with regulatory requirements, effective implementation of stress testing can also help banks to better understand their risk appetite and promote improved business discipline. As such, stress testing is an important element of all firms' risk management and control policies, limit setting and external communication.

Timeline

The BCBC issued stress-testing guidelines in 2009. These were followed by more prescriptive guidelines from the EBA for implementation by EU countries by 2012. However, as always, local timelines will vary.

EU countries	UK	US	Other Basel III countries
December 2011	December 2010	January 2012 (est.)	2013/2018

MA's holistic approach to stress testing

