



COURSE: COMESA WORKSHOP ON BASEL III

TOPIC : STRESS TESTING UNDER BASEL III

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VENUE: KENYA SCHOOL OF MONETARY
STUDIES

FACILITATOR: SIMON G. GICHUKI

AGENDA

- Stress Testing –What and Why?
- Principles for sound stress testing and supervision.
 - Use of stress testing and integration in risk governance
 - Stress testing methodology and scenario selection
 - Specific areas of focus
 - Recommendations to supervisors

A). STRESS TESTING WHAT AND WHY?

- Stress testing is commonly described as the evaluation of the financial position of an institution under a severe but **plausible** scenario to assist in decision making.
- Stress testing alerts bank management to adverse unexpected outcomes related to a variety of risks and provides an indication of how much capital might be needed to absorb losses should large shocks occur.
- Stress Testing play s an important role of:-
 - providing forward-looking assessments of risk;
 - overcoming limitations of models and historical data;
 - feeding into capital and liquidity planning procedures;
 - informing the setting of a banks' risk tolerance; and
 - facilitating the development of risk mitigation or contingency plans across a range of stressed conditions.

B). PRINCIPLES FOR SOUND STRESS TESTING AND SUPERVISION



- Released by BCBS in May 2009.
- Has 21 principles grouped into 4 major Categories,

Use of stress testing and integration in risk governance

- 1) Stress testing should form an integral part of the overall governance and risk management culture of the bank.
- 2) A bank should operate a stress testing programme that:
 - promotes risk identification and control;
 - provides a complementary risk perspective to other risk management tools;
 - improves capital and liquidity management and;
 - enhances internal and external communication.

B). PRINCIPLES FOR SOUND STRESS TESTING AND SUPERVISION



Use of stress testing and integration in risk governance

- 3) Stress testing programmes should take account of views from across the organisation and should cover a range of perspectives and techniques.
- 4) A bank should have written policies and procedures governing the stress testing programme. The operation of the programme should be appropriately documented.
- 5) A bank should have a suitably robust infrastructure in place, which is sufficiently flexible to accommodate different and possibly changing stress tests at an appropriate level of granularity

B). PRINCIPLES FOR SOUND STRESS TESTING AND SUPERVISION



Use of stress testing and integration in risk governance

- 6) A bank should regularly maintain and update its stress testing framework. The effectiveness of the stress testing programme, as well as the robustness of major individual components, should be assessed regularly and independently.

B). PRINCIPLES FOR SOUND STRESS TESTING AND SUPERVISION



Stress testing methodology and scenario selection

- 7) Stress tests should cover a range of risks and business areas, including at the firm-wide level.
- 8) Stress testing programmes should cover a range of scenarios, including forward-looking scenarios, and aim to take into account system-wide interactions and feedback effects.
- 9) Stress tests should be geared towards the events capable of generating most damage whether through size of loss or through loss of reputation.

B). PRINCIPLES FOR SOUND STRESS TESTING AND SUPERVISION



Stress testing methodology and scenario selection

- 10) As part of an overall stress testing programme, a bank should aim to take account of simultaneous pressures in funding and asset markets, and the impact of a reduction in market liquidity on exposure valuation.

B). PRINCIPLES FOR SOUND STRESS TESTING AND SUPERVISION



Specific areas of focus

- 11) The effectiveness of risk mitigation techniques should be systematically challenged. i.e Use of collateral.
- 12) The stress testing programme should explicitly cover complex products such as securitised exposures.
- 13) The stress testing programme should cover pipeline and warehousing risks. A bank should include such exposures in its stress tests regardless of their probability of being securitised

B). PRINCIPLES FOR SOUND STRESS TESTING AND SUPERVISION



Specific areas of focus

- 14) Reputational risk.
- 15) A bank should enhance its stress testing approaches for highly leveraged counterparties

B). PRINCIPLES FOR SOUND STRESS TESTING AND SUPERVISION



Recommendations to supervisors

- 16) Regular and comprehensive assessments of banks' stress testing programmes.
- 17) Require management to take corrective action if material deficiencies in the stress testing programme are identified or if the results of stress tests are not adequately taken into consideration in the decision making process.
- 18) Assess and if necessary challenge the scope and severity of firm-wide scenarios.

B). PRINCIPLES FOR SOUND STRESS TESTING AND SUPERVISION



Recommendations to supervisors

- 19) Under Pillar 2, supervisors should examine a bank's stress testing results as part of a supervisory review of both the bank's internal capital assessment and its liquidity risk management.
- 20) Supervisors should consider implementing stress test exercises based on common scenarios.
- 21) Supervisors should engage in a constructive dialogue with other public authorities and the industry to identify systemic vulnerabilities. Supervisors should also ensure that they have the capacity and the skills to assess banks' stress testing programmes.



Q & A



THANK YOU