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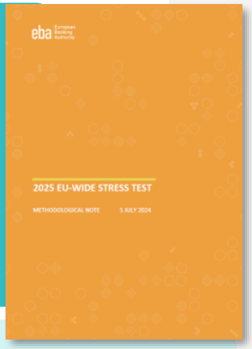
EBA EU Wide Stress Test 2025

Our views on the draft methodological note and service offering

July 2024

Executive Summary

The European Banking Authority (EBA) provided the draft methodological note* and supporting templates for the EBA EU Wide Stress Test (ST) 2025 on 5 July 2024.



The introduction of CRR3, updated methodological note and addition of new templates and calculations will increase complexity and need for capable resources to anticipate impacts and navigate the uncertainty of the 2025 ST exercise.

This document contains the following:

1. **Comparison of the draft methodological note 2025 with 2023, including expected effort required and our recommended actions (Slide 3-7)**
2. **Our service offering (Slide 8)**

Click **here** to go straight to our service offering

**The document available is subject to change and contains several errors and has some points open for consultation. Based on the 2023 ST exercise, finalisation is expected in November 2024*

- The starting point will need to be stated in actual and restated CRR3 figures, with projections depending on the latter.
- Market risk will be exempt from application of CRR3, except for Credit Valuation Adjustment (CVA). Also, new proportionality groups are introduced based on the Advanced Standardised Approach (ASA).
- Net Interest Income (NII) projections centralized and provided for to increase comparability of ST results. Additional calculations and reporting to be performed.
- Many other changes such as a new section on funding value adjustments, details on amortization of intangible assets and specific considerations for banks applying IAS 29 hyperinflation.

Overall updates

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Application of CRR3

As the Capital Requirements Regulation III (CRR3) becomes effective per 1 January 2025, the EBA has incorporated these requirements into the 2025 ST exercise. Specifically:

- Starting point values per 31 December 2024 need to be reported both under the regulatory framework that was applicable per 31 December 2024, and CRR3 (effective 1 January 2025). CRR3 shall also be applied for the projections over 2025-2027. The explanatory note will require additional detail regarding the impacts of the restatement and assumptions taken.
- Many articles were updated to reflect CRR3, including new exposure classes for credit risk, the output floor and application of transitional arrangements.
- Market risk calculations exempt from CRR3, except for CVA. For details see the market risk section in this slidedeck.
- For operational risk, capital requirement projections are constant at the restated CRR3 figures. Previously, banks were allowed to project capital requirements under the Advanced Measurement Approach (AMA).

Many banks are still working on their CRR3 implementation and being able to report and stress testing CRR3 data will be a major challenge.

Restatement of starting point values (Par. 25)

"Actual" data as per 31 December 2024

"Restated" data as per 31 December 2024

Projections over 2025-2027

CRR3 applicable

Effort

Increased proportionality

1. Proportionality elements can be applied by banks with assets below EUR 50 billion (Par. 9). In 2023, proportionality elements could only be applied by banks that enter the sample after 70% of coverage of the banking sector in the euro area, each non-euro area EU Member State and Norway was reached.

2. New market risk proportionality groups. For details see the market risk section in this slidedeck.

Effort

Recommended actions

- [ ] Assess possibility of reporting starting point values under both CRR2 and CRR3.
- [ ] Test whether current stress test environment and models are able to run based on CRR3 data. If not, enhance current environment and models.
- [ ] Conduct (multiple) dry-runs before December 2024 to test readiness of dual-reporting, stress test models and impact of CRR3.
- [ ] Determine whether proportionality elements can be applied and if so, update processes to accommodate these proportionality elements.

Credit risk

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Increased coverage country-sector combinations (Par. 107)

Minimum coverage of exposure increase from 70% to 80% for country-sector combinations. Previously immaterial sectors could now be in scope for which satellite models need to be developed and or other approaches adopted.

Effort

Clarification on what to do when no appropriate satellite models (Par. 123)

Explanatory note should detail the approach for economic sectors with no satellite model for sector level predictions. Acceptable loss distribution approaches include:

1. Sectoral sensitivities using correlation of sector specific GVA to overall macroeconomic conditions at country level
2. Allocation based on the size of the sectoral exposure at country level.

Effort

Reduced reporting requirement Public Guarantee Scheme (Par. 118)

The CSV_CR_COVID19 template is only required when PGS exposures are above EUR 750 million per 31 December 2024. Data collection is still needed to assess against the threshold and should be documented in the explanatory note.

Effort

Specific exposure classifications IRB (Par. 160)

Banks with permission to use the IRB approach for equity exposures should continue to report these exposures under the IRB approach for the restated starting points and the stress test projections.

Exposures classified as IRB 'Corporates-Large Corporates' and "Institutions" for which banks shall use the F-IRB approach, should also be classified under F-IRB for reporting the restated data, while they should be classified under the original asset classes when reporting the actual data.

Effort

Recommended actions

- [ ] Calculate the country-sector combinations needed to cover 80% of exposure and assess availability of appropriate satellite models (or develop models if not available).
- [ ] Assess acceptability of fall-back approaches used in case no sector level satellite models exist and/or develop alternative approaches in line with EBA requirements.
- [ ] Determine if PGS exposures are above or below EUR 750 million and update current processes and scripts based on the outcome.
- [ ] Test whether current systems and processes are ready for all required classifications of exposures.

Market risk, CCR losses and Valuation Reserves

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Change in calculation method of client revenues with trading intent (Par. 201, 313, 314)

Banks classified as TE are allowed to set client revenues at 80% of the average across last 3 years if data is provided. For CA and CA-Adv banks, the average across the last 3 years serves as cap in the adverse scenario. This requires availability of granular data and updating current calculations.

Effort

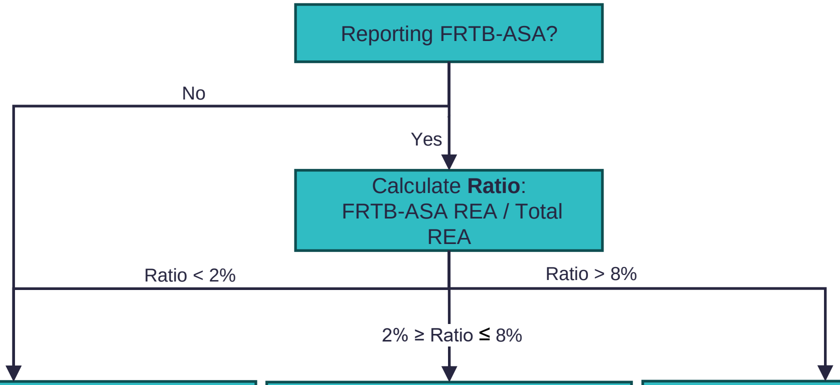
Additional default considered for CCR (Par. 202, 325, 326)

Assumption updated that three instead of two most vulnerable counterparties out of the 10 largest counterparties will default. This will lead to higher capital requirements.

Effort

Proportionality groups (Par. 199, 215, 216, Section 3.4.5. & Annex V)

Banks are classified into three proportionality groups by the supervisor before the start of the exercise based on pre-defined criteria. This provides relief for banks with limited market risk.



Trading Exemption (TE)

- No revaluation of items held with a trading intent and their related hedges.
- Impact of items held with trading intent and their related hedges set equal to zero.
- No granular reporting of delta and second other sensitivities. However, P&L and OCI impact by delta and second order sensitivities for all items NOT held with a trading income should be reported.

CSR_MR_FULL_REVAL

Comprehensive Approach (CA)

Complete submission of the full revaluation template.

CSR_MR_FULL_REVAL

CA Advanced (CA-Adv)

All CA requirements and additional detail for the revaluation of linear and optional derivatives to be provided in a dedicated template.

CSR_MR_FULL_REVAL

CSV_MR_OPT_REVAL

Effort

Recommended actions

- [ ] Determine which proportionality group applies and adjust processes and runbook accordingly
- [ ] For banks classified as TE, assess whether historical data on client revenues is available for the last three years and implement new calculation methodology.
- [ ] Calculate and analyse whether the impact of the additional default for CCR could lead to materially different stress test results

Market risk, CCR losses and Valuation Reserves

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CVA projections compliant with CRR3 (Par. 197, 343-346)

CVA calculation are to be performed in line with CRR3. Calculations and projections are dependent on which proportionality group is assigned, as well as which approach is adopted under CRR3.

Scenario	TE	CA	CA-Adv
Baseline	CVA capital charge in baseline scenario assumed to be equal to starting point		
Adverse	CVA capital charge assumed equal to starting point	Stressed CVA capital charge *BA-CVA* Obtain* and stress credit spreads, and compute EAD for each counterparty. Calculate CVA capital charge per counterparty.	Stressed CVA capital charge *SA-CVA* Apply scenarios to exposure at counterparty level, for all relevant CVA risk factors*. For each risk factor, compute all sensitivities under stress. Aggregate calculations in line with CRR3 to determine CVA capital charge. Increase in the capital charge for the adverse scenarios is floored at the relative increase of REA in the IRB portfolio.

*In the absence of market data, banks should use the regulatory prescribed spreads.

*i.e. interest rates, credit spreads, foreign exchange rates, and equity prices

Effort

Additional factors for liquidity and model risk shocks (Par. 307)

Unearned credit spreads and investing and funding costs are added.

Effort

Funding value adjustment (Par. 236 & Section 3.5.2.)

Definition and section added on funding value adjustments (FuVa) and their calculation.

Effort

Look-through for funds not allowed (Par. 262)

New paragraph clarifying that banks are not allowed to apply a look-through approach, deviating from the CRR approach. Fund positions must be stressed with the corresponding fund shocks provided in the market risk scenario.

Effort

Output floor (Par. 347)

Advanced Standardised Approach Risk Exposure Amounts (ASA REA) and Standardised Approach (STA) approach considered for calculating the output floor, keeping values constant over the projection horizon. An open question included to the banks specifically asking their view.

Effort

Recommended actions

- [ ] Based on proportionality group, determine which approach applies for CVA and ensure calculations can be performed.
- [ ] Review current models for calculation of FuVa, liquidity and model risk.
- [ ] Assess whether the bank holds fund positions and re-assess current approach if look-through approach is currently used.
- [ ] Provide input to the EBA on any concerns relating to the calculation of the output floor.

Net Interest Income and various other updates

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Updates to Net Interest Income projections (Chapter 4, Annex VIII)

Projections are provided for instead of calculated by the bank. Additional calculations are added, e.g. the Average Original Maturity (AOM).

NII for held-for-trading positions will be equal to the average of accrued interest from these instruments over the last three historical observation periods.

Effort

Additional granularity for regulated and legal exceptions in the NII template

New tables added to the CSV_NII_SUM on the following topics below, as well as a new template CSV_NII_CALC_FUNDING_MATCH.

- Legal floor sight deposits (Par. 398)
- Regulated sight deposits (Par. 399)
- Legally exempted new business (Par. 427, 429)

This is only applicable to specific countries and products as referred to in the methodological note. Data processes should be ready to provide this granularity

Effort

Other updates and clarifications

- Operational risk events with a lifespan of several years should be aggregated year by year (Par. 454)
- Changes to conduct risk may occur during subsequent data submissions if new information or data becomes available (Par. 463)
- Projections of contributions to Deposit Guarantee Schemes (DGS) are allowed to fall below the 2024 value, however, description in the explanatory note is required (Par. 505)
- Considerations for banks applying IAS 29 (Par. 506, 542, 554)
- War related losses should be considered as part of operational risk (Par. 439)
- One-off adjustments for temporary levies permissible for assessment by competent authorities (Par. 514)
- Further details provided on amortisation of intangible assets (Par. 549) and new paragraph requiring explanation in the explanatory note (Par. 550)

Effort

Recommended actions

- [ ] Prepare calculations and reporting for the net interest income projections, including regulated and legal exceptions if applicable.
- [ ] Perform a line by line comparison of the draft 2025 methodological note and update the stress test processes and runbook before launch of the exercise. This slide contains a non-exhaustive list of other updates and clarifications

4most has performed a line by line comparison. An extensive Excel is available and we are more than happy to support you. See our service offering for further details on how we can help.

Our service offering

Expected timelines

2024						2025							After July 2025
July	August	September	October	November	December	January	February	March	April	May	June	July	

Phase 1 Preparation for the ST exercise & dry-run

Publication draft methodological note, templates and template guidance

Publication final methodological note, templates and template guidance

Launch of the EBA ST 2025

Phase 2 Execution of the ST exercise

(including publication of the macroeconomic scenarios)

Publication of the EBA ST 2025 results

Phase 3 Evaluation and improvement

Phase 1

Preparing the bank for the stress test exercise and ensuring compliance with the methodological note.
Example activities include:

- (Re-)development and/or recalibration of ST models
- Validation of stress ST models
- Implementation of CRR3
- Creating work-arounds in case of deficiencies
- Preparing data flows and data quality checks and reconciliations
- Drafting and/or updating the ST runbook
- Performing and/or supporting dry-run ST exercises
- Technical interpretation of methodological note
- Gap analysis of current stress testing against the methodological note and remediation of gaps
- Training sessions and materials
- Executing recommended actions (see previous slides)

Phase 2

Providing resources and technical support to handle increased workload during stress test exercise.
Example activities include:

- Data preparation, processing and template filling
- Data quality checks and reconciliations
- Running of the stress testing models
- Analysing and interpreting stress test results
- Drafting and/or review of the explanatory note
- Submitting data to the ECB Stress Test Analytical and Reporting (STAR) Portal
- Follow-up of Red Flag Report
- Technical board support on (ad-hoc) questions and troubleshooting
- Project management
- Logging findings for future enhancements

Phase 3

Supporting the process of evaluation and improvement (including remediation of findings and deficiencies).
Example activities include:

- Evaluation and review of the ST exercise to identify areas for improvement
- (Re-)development and/or recalibration of ST models
- Validation of ST models
- Remediation of findings and structurally solving work-arounds in case of deficiencies
- Enhancing data flows and data quality checks and reconciliations
- Updating the ST runbook based on lessons learned
- Assessing impact of ST results on existing risk management and capital planning

Services may be rendered on a time and material basis, staff augmentation or fixed fee

Get in touch

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