

EU-wide stress test benchmark summary report

About this study

In 2016, ORX expanded its stress testing offer and conducted a two-phased benchmark on the 2016 EU-wide stress tests. Following the publication of the EBA's updated methodological note, ORX ran a short snap survey on the methodologies used in the operational risk component in early 2018. Twenty-seven banks from 12 EU countries took part in the survey.

The final report that was shared with project participants, collated the results from the survey and gave insight not only into the methodologies, but also into the approaches firms take to identify conduct risk exposures and the use of macroeconomic factors in this stress test and more generally.

The report also served as the basis for discussions for a roundtable event that was held in May 2018 in Frankfurt.

Project roundtable – key discussion points

Thirteen representatives from eleven financial institutions attended the roundtable to discuss stress testing in the EU. This gave participants the opportunity to discuss various approaches and techniques used to perform modelling for the EU stress test

Another popular topic was the correlation between macroeconomic factors and operational risk losses, and the use of macro data in stress testing and operational risk analysis generally.

Study summary

In 2016, the European Banking Authority (EBA) considerably expanded the operational risk requirements within its stress test. Building on these, the EBA introduced some new rules in 2018, but kept the focus of the operational risk component on conduct risk.

While the EBA updated aspects of the instructions for the operational risk component of the assessment, the changes were small scale and focused on specific elements in the rules, such as the floor for other operational risk losses.

Banks are fine-tuning their approach rather than making radical changes

Given the limited changes to the EBA's instructions, banks are largely fine-tuning their approaches, rather than overhauling them. Central to these are efforts to improve the identification process for material conduct risks and forecasting of the three components that make up operational risk exposures in the EBA's tests: material conduct, non-material conduct, and other operational risk.

Estimating material conduct risk exposures differs considerably in how SME input is used

The assessment of material conduct risk losses, defined as those that are over 10 basis points (bp) of end-2017 CET1 capital levels, is largely done via case-by-case analysis (74 per cent of participants), followed by subject matter expert (SME) evaluation of unknown exposures (37 per cent). These estimates are used in different ways in participants' submissions. Some firms ask SMEs to estimate the most likely outcome and frequency, using a consensus approach, while others build loss distributions based on the different estimates. SME inputs are also used to make projections based on historical loss averages.

Several firms indicate they use SME inputs in combination with other qualitative approaches, such as scenarios, risk drivers and external loss data. Further influencing factors include the respective regulatory environments, and changes in political, legal and social environments.

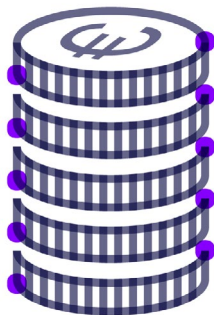
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Non-material and other operational risk losses estimated using similar techniques

The methods used for non-material and other operational risk losses are predominantly statistical methods, such as loss distribution approaches (used by over half of the respondents) or regression models (used by around a fifth of respondents). Historical loss averages are used by a third of respondents. Often the same approach is used for each category of projection. Some specific exceptions include a case-by-case SME analysis only used for non-material conduct risk, and a bootstrap analysis only used for other operational risk losses.

External loss data plays a key role, but is used very differently among respondents

Two thirds of respondents are planning to use external loss data in their submissions, often as a direct input in the model. Other ways in which external data is used is within scenario analysis or for benchmarking purposes.



Find out more

If you'd like to know more about our work on the EU-wide stress test, please contact:
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Majority use BEICF data in one way or another, while the use of risk drivers is not as widespread

Fifty-six percent of participants use business environment and internal control factors (BEICFs) in the stress test. The most common way of including them is via scenario analysis. Some participants use them as direct inputs to the model or to adjust their forecasts.

Macroeconomic factors continue to play a minor role in the stress test

Finding a sensible relationship between macroeconomic factors and operational risk losses continues to be a challenge. Only 44 per cent of respondents have conducted such a correlation analysis in the past, predominantly relating to internal stress tests or the US Comprehensive Capital Analysis and Review (CCAR). Less than 30 per cent of respondents plan to consider the effects of macroeconomic factors in their operational risk forecasts.

Managing risk together

ORX believes many heads are better than one. We're here to bring the best minds of the international operational risk community together.

By pooling our resources, sharing ideas, information and experiences, we can learn how best to manage, understand and measure operational risk and become less vulnerable to losses. For more information about ORX, our research and our services, visit www.orx.org

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