EUROPEAN CENTRAL BANK

BANKING SUPERVISION

ECB-CONFIDENTIAL

Sensitivity Analysis of Liquidity Risk – Stress Test 2019 (LiST 2019)

ECB Industry Workshop

Frankfurt am Main, 6 December 2018

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Background & Objectives presentation

Background

- **Art. 100 CRDIV** requires that competent authorities (CAs) conduct at least **annually supervisory stress tests** on the supervised institutions **as an input to the SREP**
- An **EU-wide stress-test** was conducted in **2018**
- In **2017** the ECB conducted the **Sensitivity analysis of IRRBB**

⇨ The ECB will perform a **sensitivity analysis of liquidity risk** as the annual supervisory **stress test for 2019**

Objectives

- Objective of the **workshop with the participating significant institutions (SIs)**
  - ✓ Provide an **overview of the exercise methodology and template**
  - ✓ Provide a preliminary view over foreseen **Quality Assurance process**
  - ✗ Discuss details how results from the exercise will feed into **SREP**

Key Features of the Sensitivity Analysis of Liquidity Risk

Key features

- Exercise will be a **sensitivity analysis** based on **idiosyncratic liquidity** shocks
  - **No macro-economic scenario nor market risk shock**
  - **Adverse** and **Extreme** instantaneous shocks calibrated based on **supervisory experience**
  - Shocks unfold in a **monetary policy-neutral** context
- Template based on **existing reporting requirements** and significantly **smaller than EBA ST 2018**
- Reported data will be **challenged by the ECB Banking Supervision** through a **Quality Assurance process** focused on data quality and peer benchmarking

Timeline

- The exercise will be **launched in February 2019**
- We plan **Quality Assurance** interactions to run **through May 2019**
- **Banks** to discuss individual results as part of **SREP Supervisory Dialogue in the second half of 2019**
- **No disclosure** of individual results planned

Why a stress test on exercise on liquidity in 2019?

1. Liquidity has been abundant in the euro area in recent years, yet we have witnessed **idiosyncratic liquidity crisis episodes**. We would like to make sure banks are ready to handle similar situations
2. This is also a **follow-up on our SREP analyses**, as we have found banks' liquidity self assessment (ILAAP) short of expectations in several instances
3. We would also like to **deep-dive** together with banks on certain aspects of their liquidity risk management, such as the **ability to mobilize collateral** / impediments to collateral flows
4. We would like to use this occasion to **broaden our stress test toolkit** beyond profiles covered through EU-wide exercises, as much as we did in 2017 with interest rate risk

The Liquidity stress test is part of Supervisory Priorities for 2019

Priorities 2019	Activities for 2019
Credit risk	Follow-up on NPL guidance
	Credit underwriting criteria & exposure quality (e.g. real estate, leverage finance)
Risk management	TRIM – Credit risk, market risk and counterparty credit risk models
	Improvement of banks' ICAAP and ILAAP approaches & further integration into SREP
	Assess IT & cyber risk
	Liquidity stress test
Multiple risk dimensions	Brexit preparations
	Trading risk & asset valuations

"As in 2017, the annual supervisory stress test in 2019 will be conducted with a focused scope. The 2019 stress test will seek to assess banks' resilience against liquidity shocks. The individual banks' stress test results will inform the SREP assessments."

Published on the ECB website: https://www.bankingsupervision.europa.eu/banking/priorities/html/ssm.supervisory_priorities2019.en.html#toc6

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The sensitivity analysis shall focus on heuristic shocks on banks' short term liquidity

Experts on stress testing and liquidity risk from across SSM supported the preparation of the exercise

	Key features	Notes
1.Scenario	✓ Idiosyncratic liquidity shocks with deep dives × Macro-economic / consistent scenario	– Heuristic liquidity shocks (same shocks applied to all banks) – No macro-driven scenario nor internally consistent assumptions (e.g. not all deposits can flow out of banking system at same time)
2. Time horizon	✓ Short term liquidity × Structural long term liquidity	– Focus on short term liquidity up to six months – No assessment of structural liquidity, which would require a different approach (e.g. dynamic balance sheet data; assessment of business plans etc.)
3. Risk measureme nt	✓ Focus on internal liquidity metrics × P&L impact	– Focus on cash-flow figures (e.g. survival period; net liquidity position over several time horizons) to complement 'Pillar 1' regulatory view – No P&L impact would have lead to overlaps with EU-wide ST / capital considerations + P&L generally at odds with liquidity considerations
4. Monetary policy	✓ Eurosystem collateral framework ✓ Test ability to mobilise collateral × ELA eligible collateral	– Monetary policy-neutral approach, i.e. no changes envisaged in current monetary policy operational frameworks, including for non EA central banks – Survey banks' ability to mobilise collateral within the current framework but excluding potentially ELA-eligible collateral (subject to national-level risk management decision)
5. Perimeter	✓ Consolidated level ✓ Liquidity of largest legal entities ✓ Liquidity by currency	– Focus on consolidated figures (SREP target) – More granular information at subgroup level to assess distribution of liquidity within a group – By-currency liquidity assessment (e.g. USD funding mismatches)
6. Input data	✓ Bottom-up info to be submitted by banks ✓ Re-use of existing templates, to extent possible	– Bottom up info to be requested based on existing reporting – Expected benefits from QA of existing information already provided by banks (e.g. COREP) – The template may be used by JSTs for follow-up analyses

Proposed approach combines lessons learnt with additional deep-dives on certain aspects

EA – Group
European Area

Included in LiST 2019

Cash outflows	▪ Sight / term deposits run-off ▪ No roll-over of wholesale funding
Cash inflows	▪ No liquidity generation by way of downsizing of commercial operations
Counterbalancing capacity	▪ Post haircut (central bank frameworks) valuations
Contingencies	▪ Impact on liquidity further to own rating downgrade ▪ Drawdowns on committed lines
FX deep-dive	▪ Focus on banks' liquidity position on a by-currency basis (Deep dive)
Intragroup deep-dive (by sub-group)	▪ Focus on banks' liquidity position adopting a by-liquidity subgroup view (Deep dive)
Collateral deep dive	▪ Focus on banks' ability to mobilise and generate collateral (Deep dive) Static analysis – no shocks foreseen
Memorandum items	▪ Complementary information and quality assurance

Not part of LiST 2019

- Structural liquidity NSFR NO
- Market liquidity
- Change in risk premia (other than a bank's own) / asset valuations
- Other financial market risk factors
- Macroeconomic scenario
- Geopolitical scenario
- Other types of systemic risks (e.g. CCP failure) NO
- P&L impact of liquidity shock

Cash flows will be collected for 2 shocks + 2 complementary views

Baseline contractual cash flows	▪ **No shock** → banks shall report maturity ladder figures based upon existing supervisory reporting instructions (**contractual cash flows**) for all **wholesale flows**
Adverse shock Lasting 6 months	▪ **Moderate shock** → banks shall report maturity ladder figures based on **shock parameters** provided by the ECB (e.g. run-off rates for deposits) as well as **other input** (e.g. rating downgrade)
Extreme shock Lasting 6 months	▪ **Harsh shock** → no difference in the design of the shock with respect to "Adverse" but **stronger intensity**

SREP relevant information

Collected for info only

Business view	▪ **No shock** → banks shall be free to fill this single maturity ladder **based on their expectations of roll-over of maturities** and their **business plans**

The envisaged LiST 2019 shall revolve around a core exercise complemented by ad-hoc deep dives

Legend

- ✓ Submission of template
- ✗ No submission of template

		Baseline contractual cash flows	Adverse shock	Extreme shock	Business view
"Core exercise" (fully consolidated)		✓ C66 Consolidated maturity ladder	✓ Consolidated maturity ladder	✓ Consolidated maturity ladder	✓ Consolidated maturity ladder
"Deep dives"	FX	✓ Single CCY maturity ladder	✓ Single CCY maturity ladder	✓ Single CCY maturity ladder	✗
	Intragroup (sub-consolidated)	✓ EA Subgroup maturity ladder ✓ Ex-EA Subgroups maturity ladders	✓ EA Subgroup maturity ladder ✓ Ex-EA Subgroups maturity ladders	✓ EA Subgroup maturity ladder ✓ Ex-EA Subgroups maturity ladders	✗
	Collateral mobilisation	✓ Ad-hoc reporting template	✗	✗	✗

Modified maturity ladders

Aim is to collect information on banks' ability to mobilise collateral beyond existing counterbalancing capacity

Results from the exercise will be integrated into SREP

- Integrate LiST 2019 outcome into SREP 2019 through scoring in Element 4 and arrive at findings related to liquidity risk and qualitative information*

- Inform all three Blocks** of SREP Element 4 by the LiST 2019 outcome using relative measures*** by ranking banks within reasonable homogenous groups

- Take lesson's learned from LiST 2019 to further refine SREP methodology

Overall SREP methodology stays stable – artificial volatility in results will be avoided

* e.g. assessment of data availability, timeliness and quality

** e.g. use it to challenge ILAAPs or considering it in Block 3

*** e.g. by using additional metrics like LCR cliff effect

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The SSM 2018 Liquidity template constitute the basis for the 2019 LiST template

2018 SSM Liquidity Exercise

Launch: 25-Sep-18
Delivery date: T+1
Submissions: 5 days in a row
Reference date: submission date

- Based on **ITS C.66 ladder** with a number of improvements
  - (Non maturing) **sight deposits** clearly distinguished from other O/N (contractual) liabilities
  - **Counterbalancing capacity** i) after haircut ('liquidity value'); ii) including self-originated collateral
  - Granularity in **contingent liquidity flows**

2019 LiST

Launch: February 2019, to be communicated
Delivery date: 6 weeks from launch
Submissions: single snapshot
Reference date: to be communicated

- The LiST 2019 maturity ladder will address the same phenomena (**same rows**) of 2018 SSM liquidity exercise
- Main **difference** of **LiST 2019** maturity ladders
  - **6 months time horizon** (in line with the duration of the shocks)
  - Granularity of **time buckets**
- The maturity ladder will serve as a basis for **deep-dives** analyses

Building upon the template of the yearly SSM Liquidity exercise shall allow banks to automatize the respective reporting procedures and thus, reduce the overall reporting burden.