



EUROPEAN CENTRAL BANK
BANKING SUPERVISION

Danièle NOUY

Chair of the Supervisory Board

Mr Fabio De Masi
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 17 August 2015

Re: Your letter (QZ117)

Honourable Member of the European Parliament, dear Mr De Masi,

Thank you for your letter, which was passed on to me by Mr Roberto Gualtieri, Chairman of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 14 July 2015.

To answer your question regarding the integration of systemic risk and the dynamic aspects of financial stress (including fire-sales) in future stress tests, it is worth distinguishing between, first, exercises which, like the 2016 EU-wide stress test of the EBA, focus on individual banks' resilience to stress and, second, exercises which assess the resilience of the financial system as a whole.

With regard to the 2016 EU-wide stress test, the EBA announced on 15 July 2015 that the methodology to be applied by banks will feature a static balance sheet assumption, as in the 2014 exercise.¹ This means that for banks' projections within the time horizon of the stress test, the size and composition of banks' balance sheets will remain constant. The rationale for this simplifying assumption is to assess the impact of stress without the reliance on the efficiency with which banks can implement mitigating measures. A static balance sheet assumption, therefore, fosters transparency and cross-bank consistency. For the SSM significant institutions in the EBA sample, the 2016 EU-wide stress test will be conducted by the ECB.

To address the question of how the financial system as a whole, rather than individual banks, evolves under stress, the reactions of financial agents to adverse conditions need to be taken into account. These reactions can alter and aggravate the environment in which banks operate. One important channel for such a feedback effect is contagion, either directly, via bilateral exposures, or as a consequence of fire-sales of assets. Against this backdrop, the ECB conducts internally, and on a regular basis, stress-testing analyses that take into account systemic risk and contagion effects, including fire-sales amplifying banks' losses under stress scenarios. The methodology as well as future research directions were outlined in the ECB *Occasional*

¹ See the press release entitled "[EBA updates on upcoming transparency exercise and on key features of 2016 EU-wide stress test](#)", published on the EBA's website on 15 July 2015.

Paper Series, No 152 (October 2013)². Furthermore, the results of similar analyses are regularly presented in the ECB Financial Stability Review.

Yours sincerely,

[signed]

Danièle Nouy

² <https://www.ecb.europa.eu/pub/pdf/scpops/ecbocp152.pdf>