EU-wide Stress Test 2021

Regulatory analysis and overview of main impacts

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List of abbreviations

Abbreviations	Meaning
APR	All price risk
AMA	Advanced measurement approach (of operational risk)
ALM	Asset and liability management
BB	Banking book
CA	Competent authorities
CCR	Counterparty credit risk
CVA	Credit valuation adjustment
EaR	Earnings at risk
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
ECL	Expected credit losses
EIR	Effective interest rate
ESRB	European Systemic Risk Board
EU	European Union
FV	Fair value
FVO	Fair value option
FVOCI	Fair value reported in other comprehensive income
FVPL	Fair value through profit or loss

Abbreviations	Meaning
FX	Forex
HFT	Held for trading
IFRS	International Financial Reporting Standards
IRB	Internal ratings-based (approach)
IRC	Incremental risk charge
LGD	Loss given default
NCB	National Central Banks
NII	Net interest income
NTI	Net trading income
OCI	Other comprehensive income
PD	Probability of default
P&L	Profit and loss (account)
REA	Risk exposure amount (risk-weighted exposure amount)
SREP	Supervisory review and evaluation process
S1/S2/S3	Stage 1/ stage 2 / stage 3
SSM	Single Supervisory Mechanism
STA	Standardised approach
SVaR	Stressed value at risk
VaR	Value at risk

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Introduction
General characteristics

The EBA published in November 2020 the methodology, draft templates and template guidance for the 2021 EU-wide stress test along with the key milestones of the exercise

The EBA, in cooperation with the European Systemic Risk Board (ESRB), the ECB and national competent authorities, should initiate and coordinate stress test exercises to assess the resilience of financial institutions to adverse market movements.

Objective

- The objective of the EU-wide stress test is to provide supervisors, banks and other market participants with a **common analytical framework** to consistently compare and assess the resilience of EU banks and the EU banking system to shocks, and to challenge the capital position of EU banks.

Common methodology

- The exercise is based on a **common methodology and scenarios**, as well as a set of **templates** to collect the necessary data to carry out a comprehensive evaluation of the banks in the sample.
  - The common methodology defines how banks should calculate the stress impact of scenarios and also establishes restrictions on bottom-up calculations.
  - It also aims to provide banks with guidelines on how to carry out the stress test. However, this methodology does not cover the quality assurance process or possible supervisory measures that should be put in place following the outcome of the stress test.
  - The templates are used to collect data from the banks, as well as to disclose the results of the exercise.

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Key aspects

Key characteristics

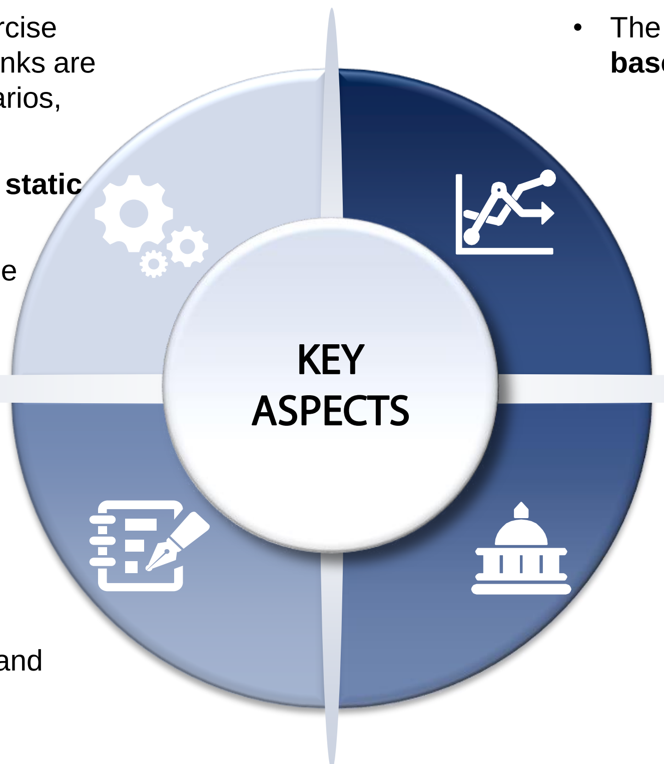
As in previous exercises, the 2021 EU-wide stress test will use a bottom-up approach and a static balance. No capital thresholds are set, but CA will apply results as an input to the SREP

Bottom-up approach and static balance

- Banks will perform the 2021 stress test exercise following a **bottom-up approach**. Thus, banks are required to estimate the impact of the scenarios, although they are subject to **restrictions**.
- The stress test will be carried out under the **static balance hypothesis**.
- Banks subject to **restructuring plans** will be subject to the same assumptions.

Baseline and adverse scenario

- The exercise includes two common scenarios: a **baseline scenario** and an **adverse scenario**.
  - The exercise will be carried out using **2020 year-end data**, over a 3-year time horizon (2021 - 2023).
  - The impact will be reported in terms of **CET1 capital**[1]. **Tier 1 capital ratio**, **total capital ratio** and **LR** will also be reported.



- Banks are required to stress:
  - **Credit risk**, including securitisations.
  - **Market risk**, **CCR** and **CVA**.
  - **Operational** and **conduct risk**.
- Banks are also required to stress **NII**, **P&L** and **equity** elements.

Covered risks

- This exercise will not be a **pass-fail exercise** (i.e. neither hurdle rates nor capital thresholds are set).
- However, the CA will use the results of the stress test as **input for the SREP**[2].

Results will be input for the SREP

(1) Both phase-in and fully loaded ratios.

(2) In accordance with the EBA Guidelines on Common Procedures and Methodologies for SREP and Supervisory Stress Testing.

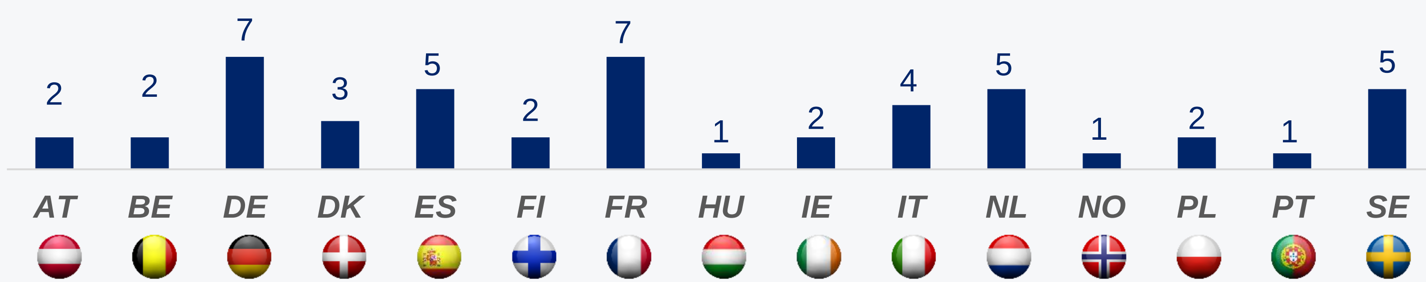
Key aspects
Sample of banks

49 EU banks will participate in the exercise covering broadly 70% of the banking sector in the euro area, each non-euro area EU Member State and Norway

Banks participating in the 2021 EU-wide stress test

- **49 EU banks** (37 are from SSM countries) will participate in the exercise covering broadly 70% of the banking sector in the euro area, each non-euro area EU Member State and Norway.
- **UK banks** have been provisionally excluded from the sample. In case the UK transitional period for negotiating additional arrangements with the EU is extended beyond 31 December 2020, UK institutions will be included in the sample of the 2021 EU-wide stress test.
- The **same inclusion criteria** are adopted as in 2018 EU-wide stress test.

Number of banks subject to the exercise by country



(1) The threshold is consistent with the criteria used for EBA reporting purposes, as well as with the SSM definition of a significant entity.

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Type of information requested
Overview

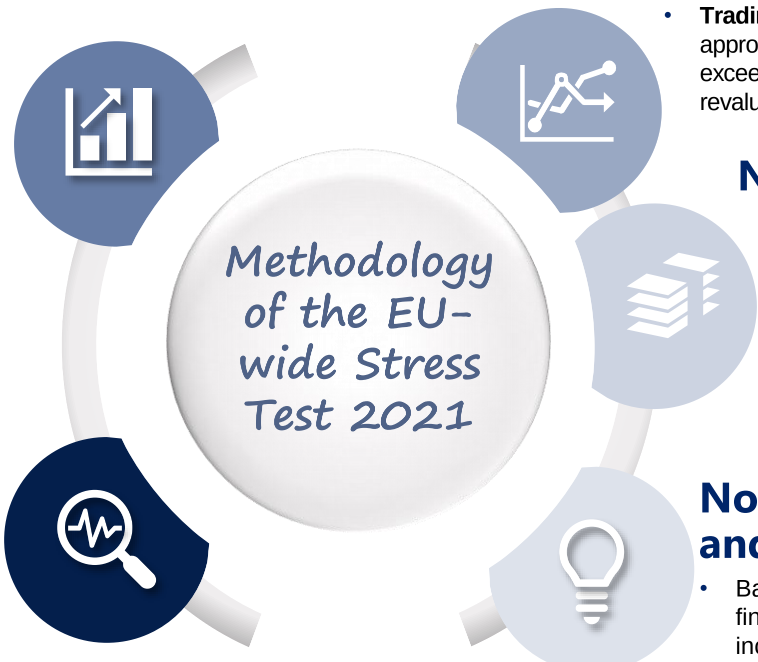
Aligned with the last exercise, the 2021 EU-wide stress test focuses mainly on assessing the impact of various risk factors on the solvency of banks.

Credit risk

- The use of **internal models** is allowed for the **projection of RWAs** (floor RWAs 2020) **and credit losses** (if no internal models are available, an ECB benchmark is applied, with high impact).
- The application of the **new definition of default** (for those portfolios reporting under ND as of Dec. 20) and the **backstop** of provisions are included.
- Treatment of public **moratoria and guarantees derived from the COVID-19**: it is assumed that moratoria will have expired on 1 January 2021, and in the case of contracts with public guarantees that expire they will be replaced by other guaranteed ones.
- A **specific template** is included to project the exposures subject to **COVID** aids.

Conduct and operational risk

- Banks will stress their **conduct risk** losses under one of the following approaches, **subject to the floors** of the exercise:
  - **Material events**: will be evaluated in a **qualitative** basis. All available information will be considered until 14 May 2021.
  - **Non-material events**: will be evaluated using their own quantitative methods.
- Losses from operational risk will be stressed using **internal methods**, subject to the **floors** of the exercise.



Market risk

- **Comprehensive Approach:** fair value measurement is to be assessed via a full revaluation after applying a common set of stressed market risk factor shocks.
- **Trading Exemption**: institutions that <u>do not have</u> a VaR model approved by the CA or the capital consumption per RM does **not** exceed 5% of the total capital consumption may not apply full revaluation on trading positions, subject to the CA's consent.

Net interest income

- The banks may use their **own methodology** and their **current projection systems** for the projection of the NII, complying with the **methodological restrictions** of the exercise (NII 2020).
- Application of **exchange rate impact** in the projection of the NII.
- **Moratoria are not considered** in the maturity schedule.

Non-interest income, expenses and capital

- Banks must use **internal methods** to estimate their non-financial income and expenses (e.g. commissions, dividend income, administrative expenses...), subject to the **methodological constraints** of the year.
- Application of **exchange rate impact** to projections of **commissions and administrative expenses (and their one offs)**.
- **Calculation of taxes per unit (and not consolidated)**.

Type of information requested
Main regulatory updates

The next EBA 2020 stress test exercise includes regulatory updates that impact the projection of credit losses

1 Moratoria and public guarantees derived from the COVID-19

- Consideration of **moratoria and public guarantees in the projection of provisions**:
  - For the purpose of calculating impairments and credit REA during the stress test horizon, banks shall assume that all EBA-compliant COVID-19 moratoria are no longer in place on 1 January 2021. The exposure volumes shall not be allocated to different stages at the reference date of the exercise (31 December 2020).
  - In relation to public guarantees, <u>contracts subject to public guarantees</u> that expire during the projection horizon will be <u>replaced</u> with the guarantee.
- Additionally, **information is requested with the detail of moratoria and public guarantees by geography and their projection** in the exercise scenarios, following EBA/GL/2020/07 (open EADs by stages, moratoria that have expired, RWAs, and credit parameters (TRs and LRs) for the main segments).

2 New definition of default (NDD)

- New regulation that rules the **definition of default exposures, among other criteria, establishing materiality thresholds** (absolute and relative) and requiring a **daily marking of default**, differentiating its application to Retail and Non-Retail exposures.
- For the purposes of the next EBA stress test exercise, it will be necessary to take into account **the application of all IRB capital calculation models that have already been approved by the ECB as of December 31, 2020** under the new definition of default, as well as to report credit exposures as of 1 January 2021 and the starting point parameters under the new definition of default.

3 Backstop (NPE coverage)

- New rules regarding **minimum coverage of losses derived from non-performing exposures (NPE)** when these are not sufficiently covered by provisions or other adjustments.
- This rule will have a **direct impact on provisions and on the capital consumption** of the stress test exercise, as a result of the deductions that will be applied to the CET1 in those cases where the NPE are not sufficiently covered.

Type of information requested
Summary of modifications by risk type

The main changes are identified below for each group of the exercise, with respect to the methodology of the 2020 stress test

Credit risk	• Taking into account the **moratoria and public guarantees** arising from the COVID in the projections: ○ It is assumed that the moratoria will have <u>expired by 1 January 2021</u>, requiring the reclassification of the exposures and provisions in the stages in which they would have been if the moratoria had not existed. The parameters of the starting point have to be adjusted in a conservative way avoiding that they would had been classified if there was no moratoria. ○ Contracts with <u>public guarantees</u> that expire within the projection horizon will be replaced by guaranteed contracts. • **Projection in an additional template of loans avoiding lower values due to moratoria and public guarantees** is requested. • Use of the **new definition of default** for the estimation of parameters for portfolios under NDD as of December 31, 2020. • **Backstop application of provisions** in the projections (additional template requested).
Market risk	• Methodology with a **high degree of alignment** compared to 2020. • Institutions using a **simplified approach to calculating AVAs** are allowed not to include them in the exercise (including in any case the impact of the liquidity shock and model uncertainty). • Only those exposures treated under the **advanced method of CVA calculation** are included. • In IRC, for **shocks not included in the market scenario**, the adverse macro scenario will be used.
NII	• Methodology with a **high degree of alignment** compared to 2020. It includes: treatment of operations with moratoria, more detail on treatment of derivatives and mappings with FINREP. • The **maintenance of the application of the impact of the exchange rate on the margin**; it is left open to the country to include the variation against the EUR of the operations collected as NII Other.
Non-interest income, expenses and capital	• In the case of having applied the transitional provisions in the application of the impacts of the first application of IFRS9, the additional impact must be collected in each of the years. The **new transitional provisions for the impacts of the COVID are applied**. • Application of **exchange rates to the projection of commissions and administrative expenses** (and their one-offs). • Tax calculation at the **institution level**, instead of at the consolidated level.
Conduct risk and other operational risks	• **Methodology aligned with the 2020 exercise**. • Projections of losses from **conduct risk events** should take into account all information available up to the date of the second delivery (14 May 2021). • To **justify the projections**, the following may be applied: backtesting of behavioral risk losses during previous ST, projection of losses due to unknown events, ratio of new behavioral risk cases to historical ones, improvements in internal controls.

Type of information requested

Templates modifications (1/3)

Compared to the 2020 stress test, there are some templates significantly modified and new templates related to the COVID19 and NPL calendar added

Templates			
Template type	**Section or topic**	**Template name**	**Description**
CSV	Credit risk	CSV_CR_SUM	Credit risk – Summary
CSV	Credit risk	CSV_CR_SCEN	Credit risk – Scenarios (projection for credit risk losses)
CSV	Credit risk	CSV_CR_REA	Credit risk – REA
CSV	Credit risk	CSV_CR_REA_IRB	REA – IRB approach floor
CSV	Credit risk	CSV_CR_REA_STA	REA – STA floor
CSV	Credit risk	CSV_CR_COVID19	COVID-19 moratoria loans and public guarantees
CSV	Credit risk	CSV_CR_SEC_SUM	Securitisations – summary
CSV	Credit risk	CSV_CR_SEC	Securitisations
CSV	Credit risk	CSV_CR_NPL	NPL Calendar
CSV	Market risk, CCR losses and CVA	CSV_MR_SUM	Market risk – Summary
CSV	Market risk, CCR losses and CVA	CSV_MR_FULL_REV	Market risk – Full revaluation template
CSV	Market risk, CCR losses and CVA	CSV_MR_RESERVE	Market risk – Revaluation of reserves
CSV	Market risk, CCR losses and CVA	CSV_MR_PROJ	Market risk – Projection of client revenues of items held with a trading intent and their related hedges
CSV	Market risk, CCR losses and CVA	CSV_MR_CCR	Market risk – Counterparty defaults
CSV	Market risk, CCR losses and CVA	CSV_MR_REA	REA – Market risk
CSV	NII	CSV_NII_SUM	NII summary
CSV	NII	CSV_NII_CALC	NII calculation
CSV	Conduct risk and other operational risk	CSV_OR_GEN	Conduct and other operational risk losses
CSV	Conduct risk and other operational risk	CSV_OR_CON	Material conduct risk losses

☐ No or minor changes between the 2020 and 2021 stress tests (in cell format, data breakdown, etc.)

■ Significant differences between the 2020 and 2021 stress tests (in general, additional data required in each template)

■ New templates in the 2021 stress test

1. Calculation Support and Valuation.

Type of information requested
Templates modifications (2/3)

Compared to the 2020 stress test, there are some templates significantly modified and new templates related to the COVID19 and NPL calendar added

Templates			
Template type	**Section or topic**	**Template name**	**Description**
CSV	Non-interest income, expenses and capital	CSV_REA_SUM	REA - Summary
CSV	Non-interest income, expenses and capital	CSV_NFCI_DIV	Evolution of net fee and commissions income, dividend income
CSV	Non-interest income, expenses and capital	CSV_ONEOFF	Adjustments for non-recurring events (one-offs)
CSV	Non-interest income, expenses and capital	CSV_MDA	Calculation of potential distribution restriction following breach of the MDA trigger level
CSV	Non-interest income, expenses and capital	CSV_CAPMEAS	Major capital measures and material losses
CSV	Non-interest income, expenses and capital	CSV_P&L	Evolution of P&L
CSV	Non-interest income, expenses and capital	CSV_CAP	Capital
TRA[1]	N/A	TRA_SUM	Summary adverse or baseline scenario (stress test results)
TRA	Credit risk	TRA_CR_IRB	Credit risk (loss projection) IRB
TRA	Credit risk	TRA_CR_STA	Credit risk (loss projection) STA
TRA	Credit risk	TRA_CR_COVID19_STA	Moratoria and public guarantees (loss projection) STA
TRA	Credit risk	TRA_CR_COVID19_STA	Moratoria and public guarantees (loss projection) IRB
TRA	Credit risk	TRA_CR_SEC	Credit risk - Securitisations (risk exposure amount projection)
TRA	Non-interest income, expenses and capital	TRA_REA	REA (projection)
TRA	Non-interest income, expenses and capital	TRA_P&L	P&L (projection)
TRA	Non-interest income, expenses and capital	TRA_CAP	Capital (projection)
TRA	Non-interest income, expenses and capital	TRA_CAPMEAS	Major capital measures and material losses
Total CSV		**28**	
Total TRA		**10**	

☐ No or minor changes between the 2020 and 2021 stress tests (in cell format, data breakdown, etc.)

■ Significant differences between the 2020 and 2021 stress tests (in general, additional data required in each template)

■ New templates in the 2021 stress test

1. Transparency.

Type of information requested

Templates modifications (3/3)

The detail of the templates that suffer more changes as well as the new templates of this exercise are shown below

Templates			
Section or topic	**Template name**	**Description**	**Detail of changes**
Credit risk	CSV_CR_COVID19	COVID-19 moratoria loans and public guarantees	• The exposures, provisions, REA and credit parameters (PD, LGD, TRs...) under moratoriums by COVID and the new exposures subject to public guarantees are requested, both for the starting point and the projections
Credit risk	CSV_CR_NPL	NPL Calendar	• Information on exposures, current loss coverage, minimum loss coverage levels related to non-performing exposures aligned with the origination schedule and requested default date
Non-interest income, expenses and capital	CSV_REA_SUM	REA - Summary	• Breakdown of REA under phase in approach and fully loaded
Non-interest income, expenses and capital	CSV_NFCI_DIV	Evolution of net fee and commissions income, dividend income	• Greater flexibility in fees and commissions
Non-interest income, expenses and capital	CSV_CAP	Capital	• Provision deficit requested at 01/01/2020 (new dynamic) • In addition to the DTAs, information is requested on unrealized gains at fair value, with impact on OCI, due to COVID
Credit risk	TRA_CR_COVID19_STA	Moratoria and public guarantees (loss projection) STA	• The exposures, provisions, REA and credit parameters (PD, LGD, TRs...) under moratoria by COVID and the new exposures subject to public guarantees, both for the starting point and the projections, for IRB portfolios are published
Credit risk	TRA_CR_COVID19_STA	Moratoria and public guarantees (loss projection) IRB	• The exposures, provisions, REA and credit parameters (PD, LGD, TRs...) under moratoria by COVID and the new exposures subject to public guarantees, both for the starting point and the projections, for IRB segments are published
TRA	Non-interest income, expenses and capital	TRA_CAP	• Provision deficit requested at 01/01/2020 (new dynamic) • In addition to the DTAs, information is requested on unrealized gains at fair value, with impact on OCI, due to COVID

Significant differences between the 2020 and 2021 stress tests (in general, additional data required in each template)

New templates in the 2021 stress test

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Key aspects
Calendar

The 2021 EU-wide stress test is scheduled to begin in January 2021 with the publication of the scenarios, methodology and final templates, and will end in July 2021 with the publication of the results

Data quality and quality assurance
(interacción continua con el ECB durante este período)

Nov '20	Jan '21	Mar '21*	Apr '21	May '21	Jul '21	Jul '21
Publication of methodology and preliminary templates	Launch of the exercise (scenarios, templates and final methodology)	Starting point and historical information*	First delivery of results and methodological note	Second delivery of results	Final delivery to the ECB	Publication of results

NEWS

* Tentative date. Pending confirmation of final calendar

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Annex

Sample of banks

AT	Erste Group Bank AG
	Raiffeisen-Landesbanken-Holding GmbH
BE	Belfius Banque SA
	KBC Group NV
DE	Bayerische Landesbank
	Commerzbank AG
	Deutsche Bank AG
	DZ BANK AG Deutsche Zentral-Genossenschaftsbank
	Landesbank Baden-Württemberg
	Landesbank Hessen-Thüringen Girozentrale
	Volkswagen Bank
DK	Danske Bank
	Jyske Bank
	Nykredit Realkredit
ES	Banco Santander S.A.
	Banco Bilbao Vizcaya Argentaria S.A.
	CaixaBank, S.A.(1)
	BFA Tenedora de Acciones S.A(1)
	Banco de Sabadell S.A.
FI	Nordea Bank Abp
	OP Financial Group
FR	BNP Paribas
	Confédération Nationale du Crédit Mutuel
	Groupe BPCE
	Groupe Crédit Agricole
	HSBC France(2)
	La Banque Postale
	Société Générale
HU	OTP Bank Nyrt.
IE	Allied Irish Banks plc
	Bank of Ireland Group plc
IT	Banco BPM S.p.A.
	Banca Monte dei Paschi di Siena S.p.A
	Intesa Sanpaolo SpA
	UniCredit S.p.a.
NL	ABN AMRO Group N.V.
	BNG Bank N.Vv
	Coöperatieve Rabobank U.A.
	ING Groep U.A.
	Nederlandse Waterschapsbank N.V.
NO	DNB Bank Group
PL	Bank Polska Kasa Opieki SA
	Powszechna Kasa Oszczednosci Bank Polski SA
PT	Caixa Geral de Depósitos, SA
SE	Länförsäkringar Bank AB (publ)
	SBAB Bank AB – Group
	Skandinaviska Enskilda Banken - group
	Svenska Handelsbanken – group
	Swedbank - group

(1) In case the merger between Bankia and CaixaBank is approved, they will be excluded from the list and replaced by Bankinter (ES), Mediobanca - Banca di Credito Finanziario S.p.A (IT) and Banco Comercial Portugês, SA (PT)

(2) In case the period of negotiation between UK and European Union extends beyond 31 Dec20, the UK institutions would be included in the list and HSBC France would be excluded

Annex

Credit risk (1/2)

Banks are required to assess the impact of credit risk on available capital (via impairment and therefore P&L) and on RWAs

Scope	• **P&L**: covers all counterparties and all positions (including on-balance and off-balance positions) exposed to risks stemming from the default of a counterparty except for exposures subject to CCR and fair value positions[1]. • **REA**: covers the scope of the CRR for credit risk (securitisations, counterparty risk and fair value positions are included).
Impact on P&L and OCI	• Banks' must use **internal models** based on stressed point-in-time PD and LGD parameters and grade migration reflecting the losses of initially performing exposures entering into S3. • The **additional impact for initially S3 defaulted assets** initially in S3 is based on **worsening LGD**. • The **additional impact for initially S2 assets** based on **worsening LGD and lifetime PD.** • The projections take into account the probability that an asset will be reclassified to another stage (S1,S2,S3) according to its exposure to risk, over a 12-month period (Transition Rate, TR). • **Loss rates** (Loss Rate, LR) have to be reported and they refer to the expected credit losses due to stage 3 events expected over the lifetime of the exposures. • **Credit loss benchmarks** are provided for sovereign exposures. • For significant currency exposures, it is necessary to calculate parameters considering the risk associated to currency changes (**FX Lending**). • For those portfolios in which the **new definition of default** at December 31, 2020 applies, this definition will have to be taken into account both for the starting point parameters and in the projections.
Impact on REA	• Banks must comply with the **CRR requirements** on stressed regulatory risk parameters (PD and LGD) for the projection of credit REA. • For the projection of the **securitisations**, the RW defined in the methodology of the exercise will be used.

NEW **Modifications introduced compared to 2020**

(1) Thus, FVOCI and FVPL positions are excluded from the credit risk loss estimate.

Annex

Credit risk (2/2)

Banks shall assume that all EBA-compliant COVID-19 moratoria are no longer in place on 1 January 2021, requiring the adaptation of the distribution between stages after their elimination and assuming the maintenance of the public guarantees in the projection horizon

Key constraints

- The release of accumulated provisions for S3 exposures in the projection horizon is not allowed.
- No cure from S3, i.e. no transition from S3 to S2 or S1.
- The **coverage ratio** for S1 assets cannot be decreased.
- The **2020 closing REA** level serves as the floor for the total REA of the default and non-default exposures in the baseline and adverse scenarios, and separately for the aggregate IRB and STA portfolios.
- In relation to **securitisations**, the **2020 closing APR level** serves as the floor for the total APR separately for SEC-IRBA, SEC-SA, SEC-ERBA and SEC-IAA exposures.

IFRS 9 assumptions

- Provisions are estimated using a **single scenario** in each scenario (baseline and adverse).
- A perfect **predictive capacity of the macroeconomic projections** is assumed (i.e. at any point in time of the estimate the banks should assume that the subsequent behaviour of the variable is known and equal to that foreseen in the scenario).
- For **exposures S1 and S2**, and for the purpose of estimating the respective ECL after the end of the scenario horizon, it is assumed that the credit risk **parameters of the adverse scenario** (i.e. the transition probabilities of each stage and the corresponding loss rates at each stage) **revert to the credit risk parameters in the 2023 baseline scenario**. A linear reversion of 6 years is assumed. For exposures S1 and S2, it is assumed that the credit risk parameters in the baseline scenario remain stable after the end of the scenario horizon.

Moratoria and public guarantees COVID19

- All moratoriums are assumed to **expire 1 January 2021**.
- The **distribution of exposures and provisions between stages at the beginning of 2021 needs to be adapted** to reflect the impact of the elimination of the COVID-19 moratoriums. It is necessary to **adjust the parameters of the starting point** (Jan-21) in a conservative way, eliminating the effect of the moratoriums. NEW
- **Contracts subject to public guarantees** derived from the COVID **that expire** during the projection horizon will be replaced with the guarantee, regardless of when the guarantee ends.

Market risk, CCR and CVA

The impact of market risk on the positions accounted for in FV should be assessed by a full reassessment after applying a set of market risk factors

Scope	• **P&L**: covers positions valued at FVPL, FVOCI and FVO (including sovereigns), hedge portfolios for positions valued at FV, positions for which CVA is calculated and positions subject to CCR. • **REA**: covers the scope of CRR for market risk and CVA.
Impact on P&L and OCI	• Institutions should use their own estimates for the earnings of clients in trading positions. • Full revaluation will be applied to all categories of assets with full or partial Fair Value measurement under IFRS 9. • For revaluations of assets and liabilities to FV, partial revaluation and **Taylor approximation** techniques may be applied if the entity's systems do not allow 'full revaluation'. Trading instruments and their respective hedges are excluded from the scope. • Shocks will be included to **reflect model uncertainty** in the calculation of Fair Value adjustments. • Banks will assume the default of the 2 most vulnerable counterparties within their 10 largest net CCR exposures with stressed collateral.
Impact on REA	• Constant REA for **STA approaches**. • Constant **VaR** in the baseline scenario and replaced by **SVaR** in the adverse scenario**.** • Capital requirements by CVA and ICR stressed (complementing the adverse macro scenario). • The APR will be constant in the baseline scenario and scaled in the adverse scenario. NEW
Key constraints	• The base scenario will not be impacted. • **Simplified approach** for banks with trading exemption: 0.20% of the sum of the FV of assets and liabilities • The simplified approach serves as a floor for the impact of the comprehensive approach. • **NTI in the base scenario** will be the minimum of the average of the last 2, 3 and 5 years. • Banks' own projections for client revenues capped at the larger of 75% of client revenues and 75% of baseline NTI. • The increase of IRB REA serves as a floor for REA by IRC and CVA.

NEW **Modifications introduced compared to 2020**

Net interest income (1/2)

Banks will be able to use their own methodology and their current ALM systems and EaR models to project their IRS

Scope	• **P&L**: all **positions involving the collection or payment of interest** of all accounting categories, including both instruments valued at amortized cost and those accounted for at fair value, such as HFT, AFS, FVO positions and accounting hedging instruments. Any **contractual arrangements that do not conform to the static balance sheet assumption are outside** the scope of the NII methodology.
Impact on P&L and OCI	• Banks may use their **own methodology to estimate NII** based on the repricing of their portfolio and estimates of risk-free rates and margins under the baseline and adverse scenario.
Key constraints	• **NII cannot increase** under the adverse scenario. • Under the adverse scenario, the **assumptions cannot lead to an increase in the bank's** NII (at the group level) compared with the 2020 value, before considering the impact of the increase of provisions for NPE. • Under the adverse scenario, banks are required to **project income on non-performing exposures net of provisions** subject to a cap on the applicable EIR, while under the baseline scenario, they must reflect at least a proportion of the changes in the country's sovereign bond spread of the exposure in the **margin component of the EIR** of their repriced liabilities. • Under the adverse scenario, the **margin paid** on liabilities cannot increase less than the highest amount between a proportion of the increase in the sovereign spread and that of an idiosyncratic component. • The increase of the margin on repriced assets is capped at a proportion of the increase in sovereign spreads. • Banks that **present interest income from assets in FVOCI and FVPL** as part of NTI **must declare this income as part of NII and withdraw it from the recurring NTI**. • For **interest rate derivatives**, **it is required to break down each of the tranches separately**, considering them as an asset and a liability and recording the income from each of them (even if they do not apply this treatment for accounting purposes). • Adjustment on the NII **for the effect of exchange rate in countries with high inflation**. This adjustment is made based on the table of exchange rate variation with respect to the EUR for each currency provided by the regulator. Each entity is allowed to complete this variation for operations classified as "Other". NEW

NEW **Modifications introduced compared to 2020**

Annex

Net interest income (2/2)

Banks will be able to use their own methodology and their current ALM systems and EaR models to project their IRS

Key constraints

- **Moratoria that meet EBA requirements, both legislative and non-legislative, will not be taken into account for the reporting of baseline data and projections**, in order to maintain clarity of information:
  - The contractual expiration will be the one prior to the application of the moratoriums;
  - The maturity schedule will not reflect the effect of the moratoriums, that is, the operation will expire in accordance with its conditions prior to the moratorium;
  - The EIR, including the division into reference and margin components, will be carried out taking into account the contractual conditions prior to the moratorium.
- The publication of the ST 2021 exercise, includes **further detail on:**
  - The treatment for reporting derivatives;
  - Instruments with legal floors;
  - Deposits at BBCC that are subject to a 0% rate (i.e., the level exempt from excess liquidity will not need to be stressed but should appear with EIR 0% in both scenarios and the volume should be indicated in the explanatory note);
  - Calculation of the sovereign spread;
  - mapping that the information must meet with respect to the data reported in FINREP;
  - Request for justification/explanation in the methodological note.

NEW

NEW

Conduct risk and other operational risk

Banks will estimate the impact of losses from conduct and operational risk on P&L, using, when relevant, their internal models and may use a qualitative approach to certain behavioral events

Scope

- **P&L**: impact of potential future losses arising from conduct risk and operational risks.
- **REA**: CRR scope for operational risk.

Impact on P&L and OCI

- Banks will estimate the impact on P&L of losses from these risks, using their **own estimates**.
- For **material conduct risk losses**, banks will apply the **qualitative approach** when reporting any historical and **material behavioral events** during 2016-20 or new events, or if the CA deems it necessary.
- For **non-material conduct losses and operational losses**, a **quantitative approach** will be applied.
- Projections of losses from conduct risk events should **consider all available information** up to the date of the second submission to the EBA (14 May 2021).
- When banks cannot provide historical data, losses will be calculated as a function of **gross income** (relevant indicator) as a last resort approach.

Impact on REA

- Banks can use their **own projections** for AMA, basic and standard approach.

Key constraints

- Losses from **new conduct risk events** are subject to a **floo**r, computed in the baseline scenario as the average of historical conduct risk losses reported during 2016-20 and applying a multiplier (x 2) to that average in the case of the adverse scenario.
- **Material behavior events** will be subject to **a floor in the QA process**, having to justify in the QA process projections below the floor (1.15 x average material losses from 2016-20).
- **Operational risk** losses are subject to a **floor** calculated in the baseline scenario as the average of historical losses in the period 2016-20 by a multiplier, and applying to this average a multiplier (x 1.5) in the case of the adverse scenario.
- The **capital requirements** for operational risk **cannot fall below the 2020 value**.

NEW **Modifications introduced compared to 2020**

Annex

Non-Interest Income and Expenses (1/3)

Banks will use their own methodology to estimate their non-interest income and expenses not covered by credit risk, market risk or operational risk in the baseline and adverse scenarios

Scope	• **P&L**: Non-financial income and expense projections exclude any P&L position and capital impact covered by credit, market, operational or net interest income risk. • Inclusion of **DTAs** in scope: DTAs that are not based on profitability are constant in the stress test. In the loss periodification, the DTAs created during the stress test are prioritized.
Impact on P&L and OCI	• Banks' **own estimates**, but subject to constraints for specific P&L items. • Market risk methodology and macroeconomic shocks applied for **non-financial assets** and defined benefit pension plans.
Key constraints	• Dividend income, NFCI and the share of the profit of investments in subsidiaries, joint ventures and associates outside the scope of consolidation **cannot exceed the 2020** level in the baseline, while a minimum reduction of net income from each item compared with 2020 is prescribed for the cumulative projections in the adverse scenario. • Other **remaining administrative expenses, remaining other operating expenses, depreciation and other provisions** or reversals of provisions cannot fall below the 2020 value, unless an adjustment for one-offs is permitted. One-off adjustments are subject to a threshold of 5bps of 2020 REA. • Common tax **rate of 30%** applies. The stock of existing DTAs and DTLs as of 31 December 2020, will not be recalculated in accordance with the simplified tax rate. Banks can use and create both DTAs that depend on future profitability and do not arise from temporary differences and DTAs that depend on future profitability and arise from temporary differences (only for OCI) during the stress test, subject to some simplistic assumptions. The creation of DTAs that are not based on future performance is not allowed. The DTLs shall be kept constant over the stress test horizon.

NEW **Modifications introduced compared to 2020**

Non-Interest Income and Expenses (2/3)

Banks will use their own methodology to estimate their non-interest income and expenses not covered by credit risk, market risk or operational risk in the baseline and adverse scenarios

Key constraints

- **No impact** on incurred profits or losses, negative goodwill, or foreign currency effects are assumed.
- **Other operating revenues** is capped at the 2020 value. The income related to operating leasing is subject to a minimum reduction of 10% with respect to the 2020 value in the adverse scenario.
- For **dividends paid**, the pay-out rate must be based on publicly declared dividend policies. If no dividend policy is available, the pay-out rate in the baseline scenario is the maximum value between 30% and the median pay-out rate in the years 2015-2019 in which profits were recorded; while in the adverse scenario the same pay-out ratio is assumed (0 in the years in which the institutions are in losses).
- If the CET1 ratio projected for a given year of the stress test horizon falls below the MDA trigger point in line with Article 141 of the CRD, banks are required to **project of distributions for the same year following some** simplifying assumptions for the purpose of the stress test.
- In the case of **having applied the transitional provisions in the application of the impacts of the first application of IFRS9**, the additional impact must be collected in each of the years.
- **Profits from investments in subsidiaries may not exceed 2020 levels**. Additionally, in the adverse scenario a reduction in the projections is prescribed.
- **Income from commissions**, if the internal model is applied, cannot exceed an annual fall of 10% over that reported in 2020 (real data).
- **Incorporation of the FX effect into NFCI projections,** the minimum reduction/capitalization should be applied per currency. NEW
- **"Other remaining administrative expenses" and the respective one-offs** (if any) must be adjusted for foreign exchange purposes. NEW
- To cover the inclusion of the impact of FX on NFCI and other administrative expenses it will be necessary to **report the opening by currency in the inputs tab**. NEW

NEW **Modifications introduced compared to 2020**

Annex

Non-Interest Income and Expenses (3/3)

Banks will use their own methodology to estimate their non-interest income and expenses not covered by credit risk, market risk or operational risk in the baseline and adverse scenarios

Key constraints

- **Tax calculation at legal entity/country** level in accordance with relevant and applicable tax legislation.
- **The treatment of software assets for intangible asset deductions is detailed.**
- Banks will report their respective **Pillar 2 (P2R) requirement, effective and applicable as of 31 December 2020**. This requirement will remain constant over the stress test horizon (2021, 2022, and 2023) for both the baseline and adverse scenarios. In the case where a P2R decision was taken and communicated to the bank in the course of 2020 but it is first applicable as of 1 January 2021, this new P2R should be reported under the year 2021 and kept constant for the remaining years of the stress test horizon (2022 and 2023).

NEW Modifications introduced compared to 2020