
Press release

AFME welcomes start of 2023 EU-wide stress test

31 January 2023

Following the launch of the EU-wide stress test by the European Banking Authority today, the Association for Financial Markets in Europe (AFME) issued a statement on behalf of its members, the majority of which will be part of this year's test.

Caroline Liesegang, Head of Prudential Regulation at AFME, said: *"Region-wide stress tests are an important element of idiosyncratic and systemic risk assessments at banks under common macro scenarios. This year's stress test is particularly interesting, given that this is the first time European entities of third country firms are part of the exercise. Their inclusion allows for a comparison of the robustness of operations of all large banks that provide important wholesale market services in support of the European economy. The stress test also gives insights into one of the most pressing macro-financial issues, i.e. the reversal of interest rate levels back towards long-term trends. However, this year's EBA methodology puts undue restrictions on bank's interest earning capacity, which may negatively impact the assessment of banks by their investors."*

In particular:

- AFME notes the increased sample now includes larger entities of third country banks due to the size and complexity of their operations in the EU. The exercise will help banks and supervisors alike to understand the commonalities and differences across jurisdictions. Going forward, AFME also suggests regional stress test methodologies could be further aligned across the world with a view to harmonising requirements for banks and reducing the related operational burden.
- AFME welcomes the EBA's and ESRB's recognition of the effect of interest rate paths across jurisdictions on banks' risk profiles and income. However, AFME cautions that this year's stress test methodology mechanically controls banks' net interest income and thereby artificially constrains firms' ability to account for interest income even under a rising interest rate scenario. Under this methodology banks will show higher losses than they would actually incur given their business model. This might have an unintended impact on investors raising questions around banks' seemingly higher sensitivity to macro shocks.
- Inflation is projected to play a key part in the functioning of the world economy over the next years reverting to target inflation levels by the end of 2025 under the baseline scenario for the Euro area, UK and US, and hovering around the 3% mark under the adverse scenario. Therefore, this will most likely not drive the impact significantly.
- AFME notes that successful supervisory stress tests require adequate quality assurance. This lies in the hands of the (national) competent authorities. AFME encourages supervisory authorities to engage in informed conversations with firms when assessing the results and to allow banks sufficient time to run the calculations. It is essential to strike a good balance between cross-sectional benchmarking and recognition of idiosyncratic specificities in the results.

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About AFME:

AFME (Association for Financial Markets in Europe) advocates for deep and integrated European capital markets which serve the needs of companies and investors, supporting economic growth and benefiting society. AFME is the voice of all Europe's wholesale financial markets, providing expertise across a broad range of regulatory and capital markets issues. AFME aims to act as a bridge between market participants and policy makers across Europe, drawing on its strong and long-standing relationships, its technical knowledge and fact-based work. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) through the GFMA (Global Financial Markets Association). For more information please visit the AFME website: www.afme.eu.

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