

3 Key Insights into Stress Testing and what they mean for Banks

In risk management, stress testing has become a pre-requisite to regulatory reporting requirements. Today, stress testing is a crucial recurring activity for most banks, involving various functions (Risk, Finance, Treasury, etc.) and processes. Without a robust forecasting process and stress testing framework in place, banks may not be able to meet their regulatory capital requirements, in turn leading to potential turmoil in financial markets. Therefore, it is important for banks to put in place a robust and consistent framework to address regulators' requests in a timely manner. Listed below are three key insights I gathered working with banks and financial institutions at Acuity Knowledge Partners.

1. **Despite some differences among jurisdictions (FED, EBA, PRA), it is clear that regulators understand the importance and urgency around stress testing and have “risen the bar”.**As a result, it is essential to hire, train, and retain talented people with the right skill and experience in areas such as revenue and balance sheet modeling, loss estimation, scenario development, model governance, data management and infrastructure, process redesign, and documentation. The roles of these stress-testing professionals have evolved rapidly within organizations and will need to evolve further, especially with regulatory pressure likely remaining strong in the future.
 2. **Stress testing no longer follows a pre-set course and has expanded to multiple extensive scenarios.**Given stress testing's expansion into multiple extensive scenarios, financial institutions will not only have to rethink these expansion scenarios but also revisit their existing models and adopt new tools that will make this entire process smoother. In short, they will primarily benefit by breaking the traditional “silos” approach, which is likely to provide opportunities to rethink data, models, scenarios, tools, and governance to be consistent and effective.
 3. **Risk executives no longer have unlimited cheque books, and they need to show “business value and return on investment” in their 2021 vision.**To gain value from the stress testing process, it is crucial to find unique low-cost models and use the stress testing framework for all strategic activities of the bank. Stress testing should also not be perceived as a mere periodic exercise, but as an opportunity to use the results to make business decisions. Stress testing should not be limited to the model developers and model end users' level, but also include those at the board of directors and senior executives' level. For instance, stress testing should be implemented across different verticals of each bank to define limits and pricing for capital planning
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and allocation, strategic planning and mergers and acquisitions, and for any other strategic decisions.

I take this moment to invite you to the "Stress Testing Europe 2016" event, which is to be held on October 5-6 in London. I will be presenting the aforementioned insights and relevant case studies related to alternative solutions towards stress testing.

Acuity Knowledge Partners provides both insight and assistance, working across the global regulatory landscape with experience across modeling, validation, regulatory documentation, business intelligence, and data management. Our experience in creating value and simplification across bank infrastructure, improving the silo process, risk appetite frameworks, and stress testing across retail, wholesale/structured credit and market risk landscapes make us a unique helping hand for banks still trying to solve these issues.

About Acuity Knowledge Partners

Acuity Knowledge Partners is a leading provider of high-value research, analytics and business intelligence to the financial services sector. The company supports over 300+ financial institutions and consulting companies through a team of over 2,500+ subject matter experts who work as an extension of the clients' teams based out of various global delivery centres.

We empower our clients to drive revenues higher. We innovate using our proprietary technology and automation solutions. We enable our clients to transform their operating model and cost base.