



SPI Project:
**Methodological Aspects of Stress Test
For Banks Covering Households and
Firms Exposures**

Regulatory Impact Assessment
Approach Note

Background* - 1

Stress tests permit a forward-looking analysis and a uniform approach to identifying potential risks, generated by exceptional but plausible shocks, to the banking system as a whole, but also to individual institutions. System-wide stress tests can complement stress tests conducted by individual institutions, by acting as a cross-check for their own analyses and by identifying weaknesses in data collection, reporting systems, and risk management processes and practices. The process itself can help to increase expertise in risk assessment by supervisors and the institutions involved, and promote cooperation and a broader understanding of risks by different stakeholders.

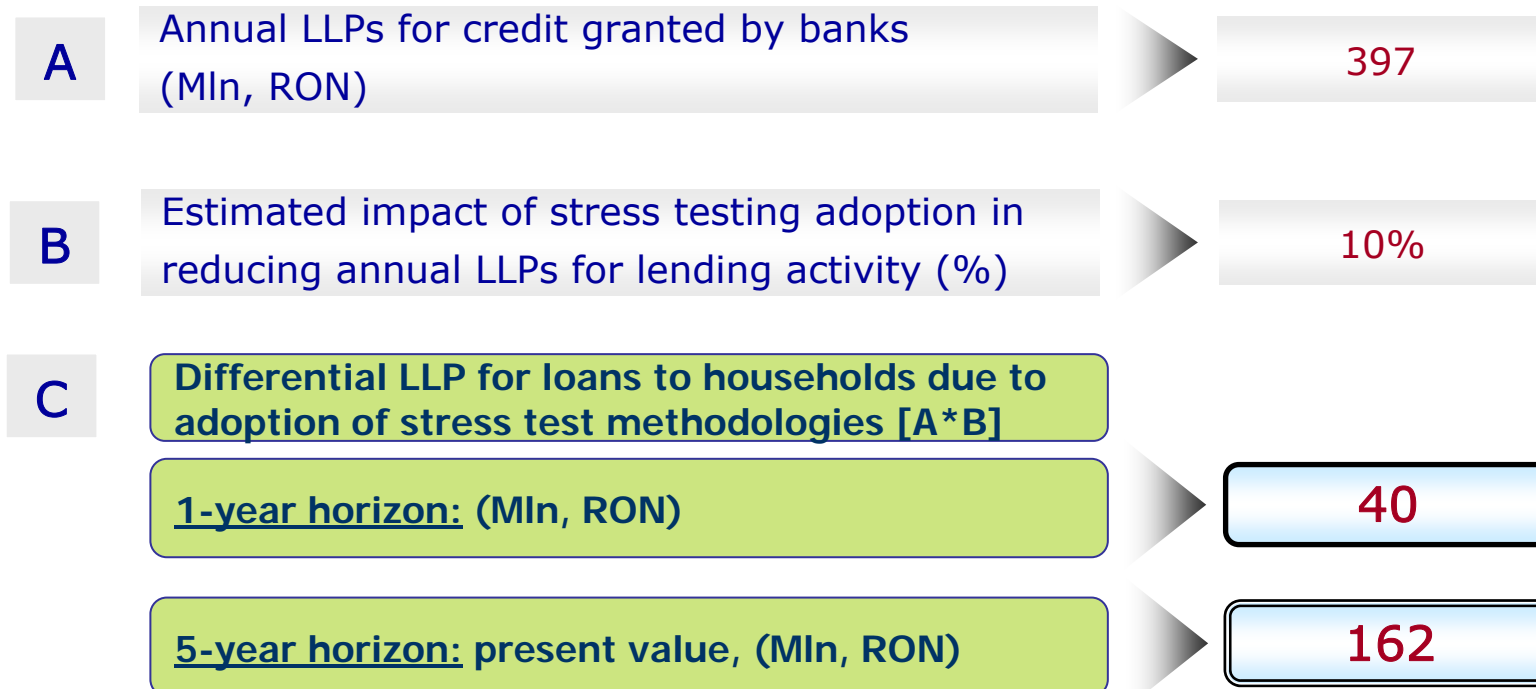
Financial institutions and authorities have long recognized the strong interdependencies between the profitability and balance sheet soundness of financial intermediaries and the creditworthiness of households and firms. A stress test covering households and firms exposures could offer important indications on their capacity to withstand macroeconomic shocks (such as sharp movements in interest rates, exchange rates, GDP, employment) and how their debt servicing capacity could affect the banking sector.

Background* - 2

At present, the National Bank of Romania and credit institutions do not have comprehensive and homogenous models to stress test the households and corporate sectors credit exposures. So far, NBR has developed a logit model that estimates the probability of default for the corporate sector, which is not integrated into a model that stress tests the entire financial system. Likewise, NBR is in the process of gathering data concerning the household sector in order to develop a model that reveals the links between the ability of households to service debt (i.e. probability of default) and the financial system. Such models could also help the individual banks to strengthen evidence supporting loan loss and general reserve provisioning, and credit risk strategies to reduce credit risk cost. No information is available on whether such models are developed by local financial institutions.

Economic impact assessment - 1

This is a static representation of the methodology



Analytics - 1

Overall annual net provisions expenses under RAS (Mln,	a)	397
Estimated impact of stress testing adoption in reducing annual LLPs for lending activity (%)	b)	10%
Annual savings in LLPs for lending activity due to benefits from stress testing application (Mln, RON)	c)=a*b	40

		2007	2008	2009	2010	2011	5-year NPV
PV - Annual savings in LLPs for lending activity due to benefits from stress testing application (Mln, RON)	i)	37.1	34.6	32.3	30.2	28.2	162

Discount rate (%)	7.10%				
Discount factor	0.933707	0.871808	0.814013	0.76005	0.709664

Analytics - 2

Data and assumptions:

a) Overall annual net provisions expenses under RAS (Mln, RON) 397

Source: See Preliminary RIA on IFRS. The figure here above refers to overall annual net provision expenses under RAS.

b) Annual amount of LLPs remains steady over next years.

c) Estimated impact of stress testing adoption in reducing annual LLPs for lending activity (%) 10%