

# Convergence Romania Financial Sector Modernization

Special Projects Initiative Public-Private Steering Committee



## Credit Exposure Stress Testing Techniques

SPI Committee

April 27, 2007 Meeting

### Project Objective:

Improve the NBR methodology for stress testing for companies and households and create a framework for the NBR to share its knowledge in the area of stress testing for banks with credit institutions.

## Project Working Group Activities

**PWG members: 4**

**PWG meetings: 1**

### Public stakeholders

- National Bank of Romania.

### Private stakeholders

- Banking sector (2 banks).

### Project Main Steps

Nov. 2006: Convergence appoints the project technical anchor

Dec. 7, 2006: Project strategy meeting clarifying the specific technical needs of NBR in the area of stress testing for households and corporate and its view of the feasible involvement of banks in the project

Dec. 15, 2006: NBR expresses its view according to which banks should not be involved in the project regarding the stress testing for households and companies

Jan., 2007: SPI Secretariat prepares a proposal for a project split into two parts (NBR technical assistance and stress testing for banks) and a project revival strategy

Jan.-Mar. 2007: SPI Secretariat, with the support of Convergence, mobilizes Bank of Italy to provide technical assistance to NBR

### Summary of Impact Assessment:

Government: RON 38 mil (5 year net present value) as tax revenues

Banks: RON 162 mil. (5 year net present value) in savings from stress testing adoption in reducing annual LLPs for lending activity

### For more information, please contact:

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## Credit Exposure Stress Testing Techniques

### Project Team

#### *Project Working Group*

Project Owner (PO): Ion Dragulin, NBR

Project Manager (PM): Florian Neagu, NBR

Deputy Project Manager (DPM): Viorel Hodoiu, CEC

Mihai Stoica, Bancpost

Romulus Mircea, NBR

# **SPI Project on Credit Exposure Stress Testing Techniques**

## **Project Rescue Strategy**

### **I. Actions undertaken so far**

In December, 2006, the project working group composed of representatives of banks and of the National Bank of Romania held the project strategy meeting with the participation of the technical anchor made available by Convergence. On this occasion, the NBR outlined that the Financial Stability Department (FSD) has developed two types of stress-testing models:

1. a stress testing for the banking system, which is up and running;
2. a direct stress testing for corporate and household exposure which is currently being developed (the corporate component being more advanced) and where the firms and households liabilities servicing capabilities are stressed directly in order to determine their capability to withstand revenue shocks.

The central bank mentioned that while in the case of the first type of stress testing it can be envisaged a more intense cooperation between the NBR and banks (including, for example, a possible validation of the results of the NBR stress testing with individual banks, where the Supervision Department should be also involved), the stress testing for firms and households has a stronger financial stability component and there is relatively less room for exchanging information between the two parties in calibrating the tests.

At the same time, the banks' representatives have highlighted that at the individual banks level stress testing is at its infancy and for this reason, in the area of stress testing the central bank will be the net exporter of knowledge for the benefit of the banking community.

Following the initial project working group meeting, the NBR clarified its position according to which banks should not be involved in the project regarding the stress testing for households and companies and therefore the project should be redefined to accommodate the specific technical needs of the NBR in the area of stress testing.

Based on the above mentioned considerations, the SPI Secretariat outlined to the project management group that it would be necessary to reshape the collaboration between banks and NBR in the context of the stress testing project. In this regard, the SPI Secretariat proposed to split the project into two parts:

1. addressing the specific technical needs of the NBR in the area of stress testing for households and firms get solved with the support of international experts / central banks with extensive relevant knowledge (contacts facilitated by SPI Secretariat and Convergence);
2. developing a knowledge transfer component where the central bank could support the banking community in improving its knowledge of stress testing.

The project owner endorsed the new project strategy proposed by the SPI Secretariat in January 2007.

With the support of Convergence, the SPI Secretariat mobilized Bank of Italy to provide the necessary technical assistance to the NBR for improving its stress testing methodology for households and firms. The Financial Stability Department confirmed to the SPI Secretariat that it will undertake the necessary measures to renew the twinning agreement with Bank of Italy in order to benefit from the needed technical assistance on stress testing. Likewise, in April 2007, the project owner communicated to the SPI Secretariat that he would like to withdraw from the team the persons with background on stress testing for companies and households (including the project manager). The SPI Secretariat has requested the project owner to designate a new person in the project, with expertise in the area of stress testing for banks.

## **II. Proposals for next steps**

In order to achieve the new SPI Project objective – that is, to develop a knowledge transfer component where the central bank could support the banking community in improving its knowledge of stress testing - the SPI Secretariat proposes the following project “rescue” plan:

### **May:**

- a) NBR appoints two new members in the project team: one from the Financial Stability Department (as project manager, with background on stress testing for banks) and one from the Supervision Department (as working group member, with background on validating models of banks);
- b) SPI Secretariat runs a survey with banks in order to determine the concrete areas where the central bank and the banking community could cooperate in the area of stress testing;
- c) SPI Secretariat disseminates the findings of the survey with the project working group members;
- d) A project working group meeting is held in order to discuss the results of the survey and to outline the specific contributions of NBR and banks;

### **June:**

- e) Based on the findings of the survey, NBR prepares a set of guidelines of best practices for stress testing by banks (with support of SPI Secretariat and Technical Anchor);
- f) A round table is organized with banks in order to share the central bank knowledge and guidance on stress testing with banks.