

**1. High-level requirements underpinning sound stress-testing by banks as contained in Basel Committee on Banking Supervision's publication titled: Principles for sound stress testing practices and supervision, dated May 2009.**

Principles for sound stress-testing practices for banks

- 1.1 Stress-testing should form an integral part of the overall governance and risk management culture of a bank. Stress-testing should be actionable, with the results from stress-testing analyses affecting decision-making at the appropriate management level, including the strategic business decisions of the board and senior management. Board and senior management involvement in the stress-testing programme is essential for its effective operation.
- 1.2 A bank should operate a stress-testing programme that promotes risk identification and control, provides a complementary risk perspective to other risk management tools, improves capital and liquidity management, and enhances internal and external communication.
- 1.3 Stress-testing programmes should take account of views from across the organisation, and should cover a range of perspectives and techniques.
- 1.4 A bank should have written policies and procedures governing its stress-testing programme. The operation of the programme should be appropriately documented.
- 1.5 A bank should have a suitably robust infrastructure in place, sufficiently flexible to accommodate different and possibly changing stress tests at an appropriate level of granularity.
- 1.6 A bank should maintain and regularly update its stress-testing framework. The effectiveness of the stress-testing programme, as well as the robustness of major individual components, should be assessed regularly and independently.
- 1.7 Stress tests should cover a range of risks and business areas, including at firm-wide level. A bank should be able to integrate effectively, in a meaningful fashion, across the range of its stress-testing activities to deliver a complete picture of firm-wide risk(s).
- 1.8 Stress-testing programmes should cover a range of scenarios, including forward-looking scenarios, and should take into account system-wide interactions and feedback effects.
- 1.9 Stress tests should feature a range of severities, including events capable of generating the most damage, whether through the size of loss or through the loss of reputation. A stress-testing programme should also determine which scenarios could challenge the viability of the bank (reverse stress tests) and thereby uncover hidden risks and interactions among risks.

- 1.10 As part of an overall stress-testing programme, a bank should take account of simultaneous pressures in funding and asset markets, and of the impact of a reduction in market liquidity on exposure valuation.
  - 1.11 The effectiveness of risk-mitigation techniques should be systematically challenged.
  - 1.12 The stress-testing programme should explicitly cover complex and bespoke products such as securitised exposures. Stress tests for securitised assets should consider the underlying assets, their exposure to systematic market factors, relevant contractual arrangements and embedded triggers, and the impact of leverage, particularly as it relates to the subordination level in the issue structure.
  - 1.13 The stress-testing programme should cover pipeline and warehousing risks. A bank should include such exposures in its stress tests regardless of their probability of being securitised.
  - 1.14 A bank should enhance its stress-testing methodologies to capture the effect of reputational risk. The bank should integrate risks arising from off-balance-sheet vehicles and other related entities in its stress-testing programme.
  - 1.15 A bank should enhance its stress-testing approaches for highly leveraged counterparties in considering its vulnerability to specific asset categories or market movements and in assessing potential wrong-way risk related to risk-mitigating techniques.
- 2. Relevance depending on the size and sophistication of banks**
- 2.1 The high-level requirements on stress-testing should be commensurate with the size and complexity of a bank's business and the overall risk that it accepts.