

## **ECB, BANKS INTERNAL MODELS AND STRESS TESTS**

24-hour course

### **Yassine Boudghene**

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### **Course Outline**

This 24-hour course reviews the role of central banks and in particular the ECB, both as authority responsible for monetary policy and as bank supervisor, and provides an in depth analysis of the issues associated with the internal models of banks and the stress tests of banks. These are topics that have been and will continue to be among the priorities in the financial sector in the next years.

Specifically, it provides participants with a general introduction to the different dimensions of monetary policy and the related tasks of central banks. It also reviews the Eurosystem's operational framework, including a description of the main monetary policy instruments used in practice and the main issues facing central banks when implementing monetary policy.

It offers a general assessment of the initial steps of the Banking Union, an overview of the organisational setup of the Single Supervisory Mechanism (SSM) and the main challenges facing the SSM, as well as a practical overview of the supervisory tasks conducted day-to-day by the ECB together with national competent authorities (SSM) in the euro area banking system.

The second part of the course will consist in an in-depth analysis of the bank stress tests process performed by the ECB and of how internal models are designed by banks and evaluated by the ECB. On internal models, an overview of the main regulatory requirements will be provided. Then, the main steps in the life cycle of models will be reviewed and discussed, based on examples. Finally, some specific issues related to qualitative requirements, such as the governance of internal models, internal validation, the management of model changes and extensions, will be discussed. On stress tests, after an overview of the stress test methodology as used by the EBA / ECB, examples will be discussed and the results will be interpreted (based on public information).

For both topics, the course will include case studies and practical exercises illustrating key principles.

At the end of the course, Participants will be able to:

- Have a practical insight into the strategy and implementation of monetary policy in the Eurosystem and how this affects banks, and demystify the monetary policy operational framework of the ECB
- Understand the interdependences between monetary policy and the financial system, as well as the several challenges facing central banks in practice and their impact on banks
- Understand the main tasks supervisors conduct day-to-day and the main challenges the SSM is facing in the coming years
- Grasp in a practical way how stress tests are developed and how they are evaluated by supervisors
- Apprehend the key elements of banks' internal models and how the ECB exercises oversight over these models, including its TRIM initiative and the implications of this initiative for banks.

## Course Structure

- I. The ECB's monetary policy strategy and implementation**
  - a. Background/Role, objective and transmission mechanisms of monetary policy
  - b. Practical aspects
    - i. Performing the right diagnostic
    - ii. Defining the liquidity needs in the banking system
    - iii. Main monetary policy instruments: how they work in practice
    - iv. Designing the right policy response – selected examples from recent ECB decisions
    - v. Overview of selected measures taken since the financial crisis of 2008:
      1. LTROs, Targeted LTROs (next to classic MROs)
      2. Securities Markets Programme (SMP), Covered Bond Purchase Programmes, ABS Purchase Programme, PSPP, Expanded APP
      3. Cross-currency facilities
- II. Selected issues and challenges in monetary policy, for discussion**
  - a. Risk management in central banks
  - b. Collateral management
  - c. Transparency and communication
  - d. Monetary policy, financial stability and asset prices
  - e. Effectiveness of monetary policy
  - f. Emergency Liquidity Assistance (ELA)
- III. Single Supervisory Mechanism for banks**
  - a. Organisation of the SSM and decision-making at the ECB
  - b. Main highlights of the SSM regulation
  - c. Distribution of tasks between the ECB and national authorities
  - d. Role and functioning of joint supervisory teams (JSTs)/How the ECB is organized
- IV. Banking supervision in practice**
  - a. Main tasks: Off-site supervision / On-site inspections / Internal models / Event-driven tasks
  - b. SREP risk assessment
  - c. Supervisory priorities of the SSM in the euro area
  - d. Selected issues for discussion
    - i. ICAAP & ILAAP
    - ii. Intra-day liquidity and intra-day credit
    - iii. Harmonisation of the national options and discretions in the CRR / CRDIV package
    - iv. Harmonisation of the supervisory practices.
- V. Internal Models**
  - a. Review of main regulatory requirements
  - b. Life cycle of internal models
  - c. Selected issues for discussion
    - i. TRIM project
    - ii. Internal governance of models
    - iii. Internal validation of models
    - iv. Models use
    - v. Management of model changes and extensions
- VI. Stress Tests**
  - a. Objectives
  - b. Methodological considerations
  - c. Implementation of stress tests and overview of results