Annex 3

Classification of banks for the purpose of stress testing

Banks have been classified into three groups as given below:

Group A – Bank with Total Risk Weighted Assets of more than Rs.2000 billion

Group B – Bank with Total Risk Weighted Assets between Rs.500 billion and Rs.2000 billion

Group C – Bank with Total Risk Weighted Assets less than Rs.500 billion

2. A bank that falls under Group C should, at least, conduct simple sensitivity analyses of the specific risk types to which it is most exposed. This will allow such a bank to identify, assess and test its resilience to shocks relating to the material risks to which its portfolios are exposed. However, in developing its stress testing programmes, the bank should still consider interactions between risks, for example intra- or inter-risk concentrations, rather than focus on the analysis of risk factors in isolation. Even if the complexities of correlation among many of risk types are not clearly understood, an attempt should be made to qualitatively analyse the interactions among risk types and their impact on the portfolios. It is also expected that though the bank may not be able to perform complex firm-wide scenario based stress tests, it should at least, address firm-wide stress testing in a qualitative manner.

3**.** A bank that falls under Group B, in addition to what is described in paragraph 2 above, should conduct multifactor sensitivity analysis and simple scenario analyses of the portfolios with respect to simultaneous movements in multiple risk factors caused by an event. The bank should select a sufficiently realistic scenario which can impact its portfolios. Such a bank may also do qualitative analysis with respect to reverse stress testing as discussed in these guidelines. Moreover, the bank is expected to carry out both qualitative and quantitative analysis of correlations among risk types, feedback effects, etc. to get meaningful results form stress testing programmes.

4. A bank that falls under Group A should carry on stress testing programmes with all the complexities and severities required for programmes to be realistic and meaningful. These banks are expected to have an appropriate infrastructure in place to undertake a variety of stress testing approaches that are covered in these guidelines from simple portfolio based sensitivity analyses to complex macro scenario driven firm-wide exercises. Moreover, these institutions are expected to include in their stress testing programmes rigorous firm-wide stress tests covering all material risks and entities, as well as the interactions between different risk types. The banks are expected to conduct reverse stress testing on a regular basis. While those Group A banks which have been conducting such stress may continue doing so, those which have not yet commenced such stress tests are expected to start doing so from April 1, 2015.

5. There may be banks in any of the above categories, which may be part of the Group or/and operating internationally. Additional firm-wide stress testing programmes for such groups should be conducted at consolidated level to understand the risk at aggregate level and implications for the group. As other domestic and foreign regulators would be involved in such consolidated entities, they are expected to discuss the stress testing issues with the concerned regulators.