Contents

Introduction ......................................................................................................................................................................................... 1

Stress testing principles .................................................................................................................................................................. 3

1. Stress testing frameworks should have clearly articulated and formally adopted objectives ....... 3
2. Stress testing frameworks should include an effective governance structure ................................. 3
3. Stress testing should be used as a risk management tool and to inform business decisions ....... 4
4. Stress testing frameworks should capture material and relevant risks and apply stresses that are sufficiently severe .................................................................................................................................................... 6
5. Resources and organisational structures should be adequate to meet the objectives of the stress testing framework .............................................................................................................................................. 7
6. Stress tests should be supported by accurate and sufficiently granular data and by robust IT systems ................................................................................................................................................................................ 7
7. Models and methodologies to assess the impacts of scenarios and sensitivities should be fit for purpose ........................................................................................................................................................................ 8
8. Stress testing models, results and frameworks should be subject to challenge and regular review ........................................................................................................................................................................... 9
9. Stress testing practices and findings should be communicated within and across jurisdictions . 10
Introduction

The Basel Committee previously published stress testing principles in May 2009. The 2009 principles were designed to address key weaknesses in stress testing practices that were highlighted by the global financial crisis. Since then, the role of stress testing has rapidly evolved and grown in importance in many jurisdictions. Stress testing is now a critical element of risk management for banks and a core tool for banking supervisors and macroprudential authorities. Stress testing is integral to banks' risk management and banking supervision, in that it alerts bank management and supervisory authorities to unexpected adverse outcomes arising from a wide range of risks, and provides an indication to banks and supervisory authorities of the financial resources that might be needed to absorb losses should large shocks occur.

Given the rapid evolution of stress testing in recent years, the Committee undertook a detailed review of current supervisory and bank practices in this area. It was clear from this review that the stress testing frameworks that have been developed since the global financial crisis go well beyond those that were envisaged when the 2009 stress testing principles were developed. Recognising the increasing importance of stress testing, combined with a significant range of approaches adopted by supervisory authorities and banks, the Committee decided to update the 2009 stress testing principles. The resulting set of principles is set at a high level so that they may be applicable across many banks and jurisdictions, remain relevant as stress testing practices evolve over time, and be used by jurisdictions to guide all elements of a sound stress testing framework.

These principles cover sound stress testing practices and are formulated with a view towards application to large, internationally active banks and to supervisory and other relevant financial authorities in Basel Committee member jurisdictions. However, smaller banks and authorities in all jurisdictions can benefit from considering in a structured way the potential impact of adverse scenarios on their business, even if they are not using a formal stress testing framework but are instead using simpler methods. These principles are therefore intended to be applied on a proportionate basis, depending on the size, complexity and risk profile of the bank or banking sector for which the authority is responsible.

These principles do not constitute Standards, for which the Basel Committee expects full implementation by all of its members and the internationally active banks that they supervise. Instead the principles are Guidelines that focus on the core elements of stress testing frameworks, such as the objectives, governance, policies, processes, methodology, resources, and documentation that guide activities and facilitate their use, implementation and oversight. Nevertheless, the Basel Committee expects that, for internationally active banks, stress testing is embedded as a critical component of sound risk management and supervisory oversight and that such stress testing considers the substance of these principles.

Each principle is followed by a short description of considerations that are equally relevant for both banks and for authorities. This description is followed by two additional sets of points applicable to either, as relevant:

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3 The references to stress tests throughout the principles encompasses a range of stress testing methodologies, from sensitivity analysis, to more complex scenario analysis (including enterprise-wide stress tests) and reverse stress testing.
4 Relevant terminology can be found in the Committee’s stress testing taxonomy. For the latest version of the taxonomy available at the date of publication, please see Annex 1 of Supervisory and bank stress testing: range of practices, www.bis.org/bcbs/publ/d427.pdf.
• *Additional points for banks:* These cover additional points with particular relevance to (a) banks' own internal stress testing activities, and (b) their participation in bank-run supervisory stress tests.

• *Additional points for authorities:* These cover additional points with particular relevance to (a) supervisor-run stress tests, and (b) the authorities' role in bank-run supervisory stress tests. They also cover the role of authorities in their oversight of banks' internal stress testing activities.
Stress testing principles

1. Stress testing frameworks should have clearly articulated and formally adopted objectives

Stress testing frameworks should be designed to meet clear objectives that are documented and approved at the board level of the organisation, or an appropriately senior-level governance body. The objectives should be the basis for setting out the framework's requirements and expectations, and should be consistent with the bank's or supervisory authority's risk management framework and its overall governance structure.

Staff involved in the implementation of stress testing frameworks should also have a clear understanding of the framework's objectives, as this will help to guide any discretionary or judgmental elements.

Additional points for banks:

For banks' internal stress testing frameworks, the relevant high-level objectives should be aligned with the bank's risk appetite and risk management framework, and may relate, for example, to the use of stress tests to inform capital and liquidity planning or to their role as an integral element of risk management.

Additional points for authorities:

For authorities, relevant high-level objectives may relate to, for example: (i) assessing the adequacy of levels of capital or liquidity of supervised banks; (ii) fostering banks' own stress testing and risk management capabilities; (iii) supporting other supervisory activities (eg on-site inspections, further in-depth analysis); (iv) providing a quantitative assessment of banks' risk profiles, both for individual banks and for the banking system in aggregate; or (v) contributing to market confidence or strengthening market discipline. Authorities should communicate the intended objectives/use of stress testing results to participating banks in advance of the exercise.

2. Stress testing frameworks should include an effective governance structure

Stress testing frameworks should include an effective governance structure that is clear, comprehensive and documented. This should specify the roles and responsibilities of senior management, oversight bodies and those responsible for the ongoing operation of the stress testing framework. This governance framework should identify all key stakeholders and ensure a full and consistent oversight and monitoring of the actions taken at the different stages of the stress testing process.

Roles and responsibilities should be specified for all aspects of the stress testing framework, including scenario development and approval, model development and validation, reporting and challenge of results and the use of stress test outputs. The roles of the second and third lines of defence should be specified (eg risk management and compliance, and internal audit, respectively). Policies and procedures should cover all aspects of the stress testing framework, be clearly documented, kept up-to-date and be approved by the board and/or senior management.

The stress testing framework should also ensure collaboration of all necessary stakeholders and the appropriate communication to stakeholders of the stress testing assumptions, methodologies, scenarios and results. The engagement structure should facilitate credible challenge of the stress testing framework, both at senior and technical expert levels, including not only assumptions, methodologies, scenarios and results, but also the assessment of its ongoing performance and effectiveness, and the remediation of gaps identified by key stakeholders.
Additional points for banks:

For banks’ internal stress testing frameworks, all aspects of the governance arrangements should be specified by the bank, subject to compliance with international best practices including the Basel Committee’s *Corporate governance principles for banks*.\(^5\) The banks’ boards of directors should have the ultimate responsibility for the overall stress testing framework, including the oversight of the framework. The development and implementation of the stress testing framework may be delegated to senior management or a stress testing committee. The board, or an appropriately senior-level governance body, is expected to have an understanding of the material aspects of the stress testing framework that enables it to actively engage in discussions with senior management or senior experts that are responsible for stress testing and challenge key modelling assumptions, the scenario selection and the assumptions underlying the stress tests.

For bank-run supervisory stress tests, banks should document the governance arrangements that specify their own specific roles in these exercises. For example, relevant responsibilities likely relate to data quality control, interactions with supervisory authorities on interpretative issues, and modelling choices where these are not specified by the authority.

The bank functions that should be engaged in a given stress testing exercise depend on a number of factors, including the objectives of the framework, or particular stress test, the type of stress test (firm-wide vs more targeted), whether it is an internal stress test or a bank-run supervisory exercise, and the specific structure of the bank itself. Examples of bank functions that are likely to be relevant include economics, risk, finance, strategy and the front-line businesses.

Additional points for authorities:

Authorities should ensure that a comprehensive governance structure for all aspects of their stress testing framework is formulated by key stakeholders. The process should document a delineation of the roles for all relevant participants in the stress testing framework, inter-department (agency) coordination, and the nature and frequency of the communication of the results.

Stress testing often involves multiple units within the authority; the governance structure should guide alignment between macroprudential and microprudential functions (eg such alignment could be in terms of scenario development, data-sharing, data validation and the use of outputs from all stress testing exercises).

3. **Stress testing should be used as a risk management tool and to inform business decisions**

As a forward-looking risk management tool, stress testing constitutes a key input into banks’ and authorities’ activities related to risk identification, monitoring and assessment. As such, stress testing should also contribute to formulating and pursuing strategic and policy objectives.

When using the results of stress tests, banks and authorities should have a clear understanding of their key assumptions and limitations, for instance in terms of scenario relevance, risk coverage and model risk.

If they are to be a meaningful risk management tool, stress tests should be undertaken regularly. While ad hoc stress tests may be performed for specific reasons, generally stress tests should be undertaken, according to a defined schedule. The appropriate frequency will depend on several factors,

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\(^5\) Available at www.bis.org/bcbs/publ/d328.pdf.
including the objectives of the stress testing framework, the scope of the stress test, the size and complexity of the bank or banking sector, as well as changes in the macroeconomic environment.

**Additional points for banks:**

Banks should ensure that stress testing results, and any other relevant findings, are effectively used in accordance with the objectives and internal policies and procedures of the stress testing framework. These uses should provide insight to the board and senior management, to inform key decisions in the direction and management of the bank. For that purpose, the stress test results should be reported to the board and senior management on a regular basis, at relevant levels of aggregation. The reports should include the main modelling and scenario assumptions as well as any significant limitations.

Results of stress tests should, where appropriate, inform banks’ calibration of risk appetite and limits, financial and capital planning, liquidity and funding risk assessment, contingency planning and recovery and resolution planning. For instance, internal stress tests should support their internal capital adequacy assessments and their internal assessments of liquidity adequacy. Moreover, stress testing results should be used, where appropriate, to support portfolio management, new trade/product approval processes and to inform other corporate decision-making processes such as the evaluation of strategic options.

**Additional points for authorities:**

Authorities should make sure that stress tests are critically evaluated and properly integrated in their supervisory and/or financial stability programmes to be used along with other available analytical and/or policy instruments.

Authorities may use stress testing results as one of the inputs for the supervisory process. For instance, quantitative and qualitative outcomes of stress tests should help to identify risks and vulnerabilities to which banks may be exposed, assess banks’ capital and liquidity adequacy, as well as, where appropriate, inform reviews of banks’ internal governance and risk management arrangements. Stress tests are generally designed to quantify and inform the understanding of risks and as a result may or may not, depending on the objectives, involve hurdle rates/thresholds. When authorities use stress tests to assess banks’ capital and liquidity adequacy (eg through Pillar 2), they should also consider the appropriate supervisory responses to any deficiencies that are identified, which may include expectations for additional capital, risk reduction, or enhanced risk management, depending on the authority’s supervisory approach.

Authorities may also use, where appropriate and relevant, stress testing outcomes for macroprudential purposes, such as:

- to identify and assess risks and vulnerabilities at systemic level, possibly including additional sources of stress (eg feedback/second-round effects).
- to quantify the capital needs at systemic level during a time of crisis.
- to inform the calibration of macroprudential policies and instruments.

Where management actions are part of the banks’ supervisory stress testing submissions, authorities should consider whether the proposed actions are part of, or consistent with, the banks’ other strategic plans (such as recovery plans).
4. **Stress testing frameworks should capture material and relevant risks and apply stresses that are sufficiently severe**

Stress testing frameworks should capture material and relevant risks, as determined by a sound risk identification process. The risk identification process should include a comprehensive assessment of risks, which may include those deriving from both on- and off-balance sheet exposures, earnings vulnerabilities, operational risks, and other factors that could affect the solvency or liquidity position of the bank (or banks in the case of supervisory stress tests).

Stress test scenarios should be designed to capture material and relevant risks identified in the risk identification process and key variables within each scenario should be internally consistent. A narrative should articulate how the scenario captures the risks. If certain material and relevant risks are excluded from the scenarios, their exclusion should be explained and documented. The scenarios should be sufficiently severe and varied, given the objective of the exercise, to provide a meaningful test of banks' resilience. That is, the scenarios should be sufficiently severe but plausible.

The scenarios and sensitivities used in stress tests should be reviewed periodically to ensure that they remain relevant. Consideration should be given to historical events and hypothetical future events that take into account new information and emerging risks in the present and foreseeable future. Scenarios not based on historical events and empirically observed relationships may be warranted for some or all risks if new or heightened vulnerabilities are identified, or if historical data do not contain a severe crisis episode. The scenarios and the sensitivities should also take into account the current macroeconomic and financial environment.

**Additional points for banks:**

The scenarios and sensitivities that banks use for their internal stress tests should not be limited to those used in prescribed supervisory stress tests, although benchmarking to supervisory stress tests can be a useful exercise. Banks should ensure that scenarios are tailored to their businesses and address their bank-specific vulnerabilities. Reverse stress tests explore scenarios that could potentially lead banks to fail and thus can be useful in helping banks to identify their core vulnerabilities. In designing their own scenarios, banks should carefully determine the characteristics of each scenario, such as the severity of the stress and the types of risks that are taken into account, so that they reflect the board’s risk appetite and objectives. This design process must be transparent to internal and relevant external stakeholders (such as the banks’ supervisors).

Banks should conduct their internal stress tests at relevant levels of their organisation, consistent with the objectives (eg at a portfolio level, a business unit level, or at a firm-wide level (consolidation, solo or subconsolidated)). When looking at risks at a bank-wide level, particular attention should be paid to risk concentrations. The bank’s strategic orientation and its economic environment should likewise be taken into consideration when defining the stress test’s scope and scenarios.

**Additional points for authorities:**

When developing stress test scenarios, authorities should take into account identified specific features or vulnerabilities of individual banks (eg their risk profiles and business models) and/or the banking sector as a whole. To the extent possible, they should also take into account emerging risks if these are relevant to the objective of the stress test. Authorities may also consider developments in banks' internal scenarios and sensitivity analyses.

Given the objectives of a particular exercise, authorities should evaluate whether common scenarios could be applicable to the whole banking sector or whether tailored scenarios for specific parts of the banking sector would be more appropriate.
5. Resources and organisational structures should be adequate to meet the objectives of the stress testing framework

Stress testing frameworks should have organisational structures that are adequate to meet their objectives. Governance processes should ensure the adequacy of resourcing for stress testing, including ensuring that the resources have the appropriate skill sets to execute the framework. Resourcing decisions should take account of the fact that stress tests have become more sophisticated over time, increasing the need for specialised staff, systems and IT infrastructure.

Processes to ensure resources have the appropriate skill sets could include building the skills of internal staff, ensuring knowledge transfer to internal staff, as well as hiring personnel with specialised stress testing skills. The set of skills typically required includes (but are not limited to) expertise in liquidity risk, credit risk, market risk, capital rules, financial accounting, modelling and project management.

Additional points for banks:

Banks should ensure effective policies and internal controls are in place to govern systems and processes used in both their own internal stress testing exercise, and their participation in bank-run supervisory exercises.

Banks that adopt centralised approaches to their stress testing activities should ensure that governance systems are in place to facilitate insights from business lines, such as how their portfolios will be impacted by the stress scenarios. Banks that adopt decentralised approaches should have group level policies, procedures and controls to ensure that there is sufficient consistency in how stress scenarios are translated into impacts that can be aggregated to give a coherent view of risks the bank is facing.

If services supplied by third parties are used by banks to supplement internal resources, policies and procedures should establish appropriate due diligence, oversight and control consistent with sound third-party risk management.

Additional points for authorities:

Both bank-run and supervisor-run (eg top-down) supervisory stress tests can be resource-intensive, requiring specialised staff, systems and IT infrastructure. Authorities should ensure that resources and the organisational structure are adequate given the complexity of the exercises. For example, authorities should consider the resources needed to interact with the banks that participate in the exercises, eg processes and infrastructure to address clarifying questions from banks, interacting with banks to check data quality/discrepancies, and providing feedback to banks on the results of the exercises.

6. Stress tests should be supported by accurate and sufficiently granular data and by robust IT systems

In order for risks to be identified and the results of stress tests to be reliable, the data used should be accurate and complete, and available at a sufficiently granular level and in a timely manner. The granularity of the data should align with the objectives of the stress test (see also principle 7).

Both banks and authorities should have in place a robust data infrastructure capable of retrieving, processing, and reporting information used in stress tests to ensure that the information is of adequate quality to meet the objectives of the stress testing framework. Processes should be in place to address any identified material information deficiencies.
**Additional points for banks:**

The infrastructure capabilities of banks should be flexible enough to retrieve data for use in both internal stress tests and the bank’s involvement in any bank-run supervisory stress tests. Where appropriate, banks should ensure consistency of data sources, processing, and aggregation across their stress tests. Banks should ensure the data they produce for stress testing purposes are coherent with their overall risk management framework.

Banks should also collect, quality-assure, and maintain historical data relevant for their internal stress testing frameworks. Banks should ensure that they are able to accurately integrate data associated with mergers and acquisitions with their historical data set.

The BCBS *Principles for effective risk data aggregation and risk reporting*[^6] should guide banks in building up, revising and improving their capabilities in the use of data to enhance their ability to identify and manage bank-wide risks. In particular, banks’ risk data aggregation capabilities should be (i) subject to strong governance arrangements; (ii) supported by an adequate data architecture and IT infrastructure; and (iii) capable of capturing and aggregating all material risk data across the banking group.

The infrastructure should be sufficiently flexible to allow for targeted or ad hoc stress tests in times of rapidly changing market conditions and to meet on-demand requests arising from both internal needs and externally from supervisory queries.

**Additional points for authorities:**

Authorities should leverage, to the extent possible, data already provided by banks to authorities, such as through banks' regular supervisory reporting. Authorities should ensure consistency of data sources to the extent possible when aggregating data within supervisory stress tests, or across multiple stress tests.

Authorities should review and foster improvement of banks’ data quality and risk data aggregation capabilities as part of their on-going supervision.

**7. Models and methodologies to assess the impacts of scenarios and sensitivities should be fit for purpose**

The models and methodologies used to derive stress estimates and impacts should fit the purpose and intended use of the stress tests. This implies:

- the need to adequately define at the modelling stage the coverage, segmentation and granularity of the data and types of risk in line with the objectives of the stress test framework;
- the level of sophistication of the models should be appropriate for both the objectives of the exercise and the type and materiality of the portfolios being monitored using the models; and
- the models and methodologies used for stress tests should be well justified and documented.

Sound model development requires the collaboration of different experts. The model developers should engage with stakeholders to gain insights into the risks being modelled and to identify the business objectives, business drivers, risk factors and other associated business information that are relevant given the objectives of the stress testing framework (e.g., market, product or portfolio types, nature and materiality of risk exposures). The modelling choices and calibration decisions should consider the interactions between different risk types, as well as the linkages among models. In this regard, the links between solvency and liquidity stresses should be considered. The collaboration of model developers and

[^6]: Available at [www.bis.org/publ/bcbs239.pdf](http://www.bis.org/publ/bcbs239.pdf).
Stakeholders is particularly important for bank-wide stress testing to ensure the inclusion of all material risks and a sound aggregation of results.

Stress tests employ a certain amount of expert judgment, including assumptions within a model or methodology. In some cases model overlays are appropriate. Like the models, these overlays or expert judgments should be well justified, documented and subject to credible challenge (including, where appropriate, validation and/or independent review).

**Additional points for banks:**

The mix of a bank’s business lines, its strategy, the risk characteristics of its activities/exposures and the objective of the stress testing exercise should guide the development of appropriate models. Banks should consider a range of methodologies to quantify the stress impacts, ranging from, for instance, point-in-time static approaches to more sophisticated dynamic simulations that reflect future business activities and management actions.

Banks should ensure that adequate model inventory and model management processes are in place for their stress testing activities, including a robust model validation function. The documentation of models used for stress testing, including performance testing, should be maintained and made available to senior management and other internal and external stakeholders, such as supervisors.

**Additional points for authorities:**

Authorities that use stress testing to achieve microprudential objectives should review and challenge banks’ model outputs, for example, via review of backtesting results or peer benchmarking. They can use their own assessment criteria and, through their supervisory process, can require banks to improve their modelling and model governance procedures where needed. As part of that evaluation process, authorities may develop their own models for benchmarking or challenge purposes.

Where authorities have macroprudential objectives, their models may incorporate cross-bank features such as system-wide feedback or contagion.

8. **Stress testing models, results and frameworks should be subject to challenge and regular review**

Regular review and challenge are key steps in the stress testing process for both banks and authorities. They are critical to improving the reliability of stress test results, aiding an understanding of their limitations, identifying areas where the stress testing approach should be improved and ensuring that the stress test results are being used in a way that is consistent with the framework’s objectives. Such reviews should provide coverage of all aspects of the stress testing framework on a periodic basis and should be used to ensure that stress testing frameworks are maintained and regularly updated.

**Additional points for banks:**

Challenge during a stress test exercise should occur at multiple points and at multiple levels within the bank. Reviews should include a validation and other types of independent review of the key individual components of the stress testing process, such as review of the methodologies and scenario assumptions, and estimations of the stressed losses, revenues and liquidity forecasts. It is expected that this review would include an assessment of the overall adequacy of the exercise, eg backtesting or other benchmark comparison, and an analysis of the sensitivity of the results to the assumptions.

Challenge from the business areas of the assumptions and the plausibility of outcomes relative to market experience benefits the interpretation of results and ensures the stress test is not a pure statistical or hypothetical exercise.
When bank-wide stress tests are used to inform strategic business decisions that may affect the financial health of the institution, the board of the bank or an appropriately senior-level governance body should provide challenge to the processes, assumptions (eg scenarios and sensitivities), and outcomes of the stress test.7

As with any critical management process at a bank, the independent audit function should regularly review the bank’s stress testing framework and its implementation, both for internal stress testing exercises, and for the bank’s role in any bank-run supervisory exercise. Such reviews should be comprehensive and provide feedback on areas of improvement for the bank.

Additional points for authorities:

When authorities use the results of a stress test for purposes within their remit, there should be a challenge process to gain comfort in the assumptions driving the outcomes and the results themselves, and to duly consider model limitations and risk. This applies regardless of whether or not the stress test was conducted using bank estimates.

Authorities should regularly review banks’ internal stress testing frameworks. Supervisors should examine the stress testing results as part of their review of the internal capital adequacy assessment process (ICAAP) and the liquidity risk management of banks. In particular, supervisors should consider whether the frameworks appropriately capture all material risks areas, and consider the results of forward-looking stress testing exercises as part of assessing the adequacy of the bank’s capital and liquidity.

Authorities should also review other aspects of banks’ stress tests, such as whether they conform to their stated objectives and the governance arrangements. Supervisors should require management to address any material deficiencies that are identified in the stress testing framework, including cases where the results of stress tests are not adequately taken into consideration in the bank’s decision-making process.

9. Stress testing practices and findings should be communicated within and across jurisdictions

Communication of stress testing activities across relevant internal and external stakeholders can have benefits for both banks and supervisors. Sharing of results can, where appropriate, provide important perspectives on risks that would not otherwise be available to an individual bank or authority.

Disclosure of results of stress tests, whether by banks or authorities, can help to improve market discipline and provide confidence in the resilience of the banking sector to identified stresses. Banks and authorities that choose to disclose stress test results should carefully consider ways to ensure that market participants understand the data that are disclosed, including the limitations of and the assumptions on which it is based. The stress test’s objectives and the framework may also be disclosed where banks and authorities opt for such disclosure. This will help to reduce the risk that market participants draw ill-informed conclusions about the resilience of banks with differing or negative results.

Additional points for banks:

Banks should have processes to support regular communication and coordination between group-level stress testing functions and individual banking subsidiaries or other relevant legal entities (whether within or across a jurisdiction).

7 For example, to support the board or the appropriately senior-level governance body in the effective fulfilment of these duties, the board or the appropriately senior-level governance body may delegate the technical details to another group or body.
It is important that banking groups are able to aggregate and report stress test results across legal entities and they should seek to establish consistency of approaches and impacts across jurisdictions.

**Additional points for authorities:**

Where appropriate, authorities should foster transparency in stress testing processes and results and establish processes to communicate and coordinate stress testing activities with other domestic authorities, such as supervisory authorities, the central bank, resolution authorities and, where relevant, market conduct regulators.

Constructive dialogue between authorities and with the banking industry can help provide deeper insights into industry-level vulnerabilities and help in the conduct of the exercise, improving the quality of final stress test results.

Communication across jurisdictions includes both the sharing of stress test results among home and host supervisors of internationally active banks, subject to applicable legal constraints, as well as the international coordination and collaboration of stress testing activities across jurisdictions where this is likely to yield useful synergies. The Basel Committee’s *Principles for effective supervisory colleges (June 2014)* specifically encourage the sharing of stress testing information within supervisory colleges. More generally, authorities should also consider scope for greater cross-border collaboration on stress testing where feasible, such as through common scenarios and sharing of better practices.

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8 Available at www.bis.org/publ/bcbs287.pdf.