Chapter 20

Reverse stress testing
20.1 Application and purpose

Application

20.1.1 SYSC 20 applies to:

20.1.1A SYSC 20 applies to:

1. (a) an IFPRU investment firm; and
   (b) a BIPRU firm which meets any of the criteria in (2) on an individual basis, or in (3) on a consolidated basis.

2. Subject to (4), SYSC 20 applies to a BIPRU firm if:
   (a) it has assets under management or administration of at least £10 billion (or the equivalent amount in foreign currency); or
   (b) the total annual fee and commission arising from regulated activities is at least £250 million (or the equivalent amount in foreign currency); or
   (c) it has assets or liabilities of at least £2 billion (or the equivalent amount in foreign currency).

3. Subject to (4), where all of the BIPRU firms within the same UK consolidation group or non-EEA sub-group, taken together, as if they were one firm, meet any of the criteria in (2), SYSC 20 applies to each of those BIPRU firms as if it individually met the criteria in (2).

4. Any BIPRU firm which is included within the scope of SYSC 20 in accordance with (2) or (3) in any given year will continue to be subject to SYSC 20 for the following two years, irrespective of whether or not it continues to meet the inclusion criteria in any of those subsequent years.

Purpose

20.2 This chapter amplifies Principle 2, under which a firm must conduct its business with due skill, care and diligence, and Principle 3, under which a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.

20.3 This chapter contains rules on reverse stress testing, which require a firm to identify and assess events and circumstances that would cause its business model to become unviable. This chapter also requires the firm’s senior management or governing body to review and approve the results of the
reverse stress testing exercise. This should help the firm’s senior management to identify the firm’s vulnerabilities and design a strategy to prevent or mitigate the risk of business failure.

20.1.4A The reverse stress testing requirements are an integral component of a firm’s business planning and risk management under SYSC. For IFPRU investment firms as referred to in SYSC 20.1.1AR (1)(a), this chapter amplifies SYSC 7.1.1 G to SYSC 7.1.8 G on risk control.
20.2 Reverse stress testing requirements

**20.2.1** As part of its business planning and risk management obligations under SYSC, a *firm* must reverse stress test its business plan; that is, it must carry out stress tests and scenario analyses that test its business plan to failure. To that end, the *firm* must:

1. identify a range of adverse circumstances which would cause its business plan to become unviable and assess the likelihood that such events could crystallise; and

2. where those tests reveal a risk of business failure that is unacceptably high when considered against the *firm’s* risk appetite or tolerance, adopt effective arrangements, processes, systems or other measures to prevent or mitigate that risk.

**20.2.2** Where the *firm* is a member of:

1. [deleted]

2. a UK consolidation group; or

3. a non-EEA sub-group;

it must conduct the reverse stress test on a solo basis as well as on a consolidated basis in relation to the UK consolidation group or the non-EEA sub-group, as the case may be.

**20.2.3** The design and results of a *firm’s* reverse stress test must be documented and reviewed and approved at least annually by the *firm’s* senior management or governing body. A *firm* must update its reverse stress test more frequently if it is appropriate to do so in the light of substantial changes in the market or in macroeconomic conditions.

**20.2.4** (1) Business plan failure in the context of reverse stress testing should be understood as the point at which the market loses confidence in a *firm* and this results in the *firm* no longer being able to carry out its business activities. Examples of this would be the point at which all or a substantial portion of the *firm’s* counterparties are unwilling to continue transacting with it or seek to terminate their contracts, or the point at which the *firm’s* existing shareholders are unwilling to
provide new capital. Such a point may be reached well before the firm's financial resources are exhausted.

(2) The appropriate regulator may request a firm to quantify the level of financial resources which, in the firm's view, would place it in a situation of business failure should the identified adverse circumstances crystallise.

(3) In carrying out the stress tests and scenario analyses required by SYSC 20.2.1 R, a firm should at least take into account each of the sources of risk identified in accordance with GENPRU 1.2.30R (2).

20.2.5 Reverse stress testing should be appropriate to the nature, size and complexity of the firm's business and of the risks it bears. Where reverse stress testing reveals that a firm's risk of business failure is unacceptably high, the firm should devise realistic measures to prevent or mitigate the risk of business failure, taking into account the time that the firm would have to react to these events and implement those measures. As part of these measures, a firm should consider if changes to its business plan are appropriate. These measures, including any changes to the firm's business plan, should be documented as part of the results referred to in SYSC 20.2.3 R.

20.2.6 In carrying out its reverse stress testing, a firm should consider scenarios in which the failure of one or more of its major counterparties or a significant market disruption arising from the failure of a major market participant, whether or not combined, would cause the firm's business to fail.

20.2.7 (1) The appropriate regulator may request a firm to submit the design and results of its reverse stress tests and any subsequent updates as part of its risk assessment.

(2) In the light of the results of a firm's reverse stress tests, the appropriate regulator may require the firm to implement specific measures to prevent or mitigate the risk of business failure where that risk is not sufficiently mitigated by the measures adopted by the firm in accordance with SYSC 20.2.1 R, and the firm's potential failure poses an unacceptable risk to the appropriate regulator's statutory objectives.

(3) The appropriate regulator recognises that not every business failure is driven by lack of financial resources and will take this into account when reviewing a firm's reverse stress test design and results.