

Stress Testing for Strategic Planning

OFR Conference on Evaluating Macroprudential Tools

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Til Schuermann

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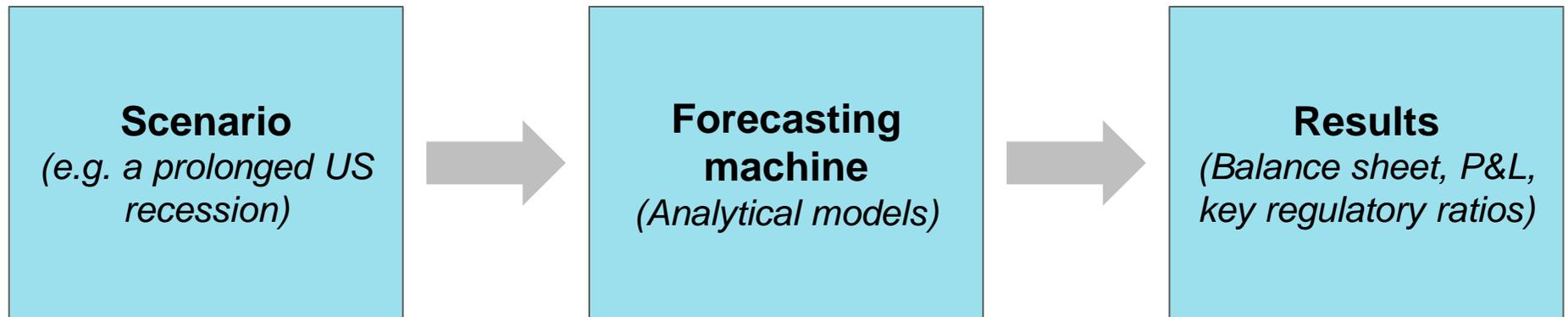
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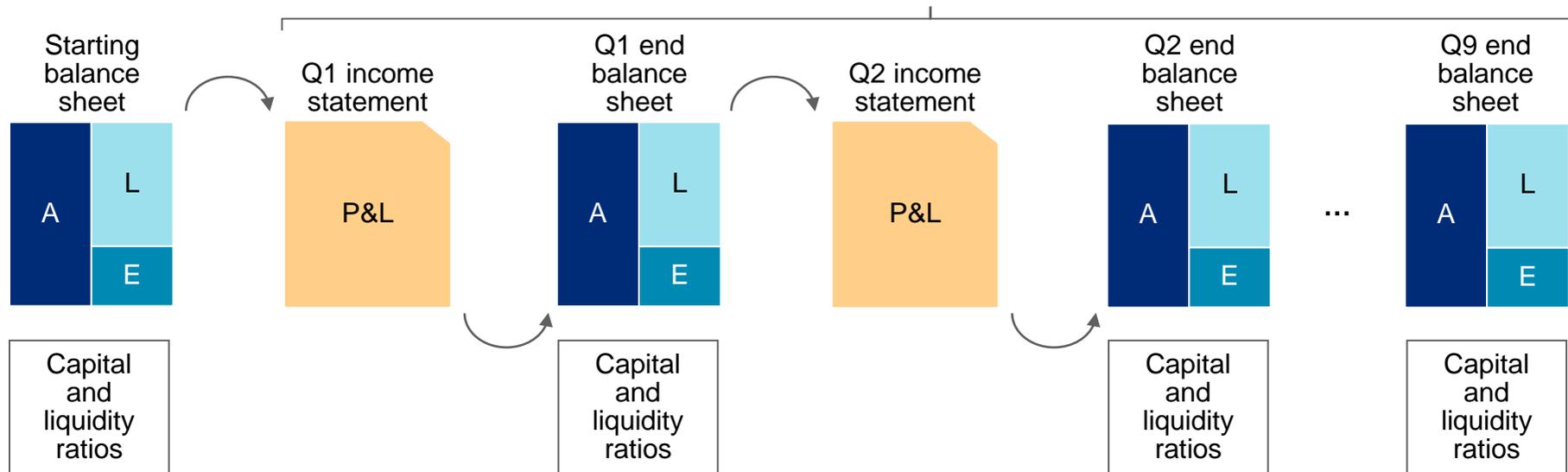
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What is stress testing?



Practically, stress testing requires dynamic projections of revenue, income, expenses, balance sheet, and regulatory ratios – so you need a lot of models!

9-Quarter dynamic forecast



This poses many hard questions



- P&L link to balance sheet: how will components of P&L change?
- Volumes and margins: what will the impact on new volume and renewals and be?
- Balance sheet evolution
 - How will the structure (term, mix and availability) of liabilities evolve?
 - How can asset and liability changes be modeled?

Models are conditional on systematic risk factors, so stress testing is rooted in a desire to separate systematic from idiosyncratic risk

It's hard to overstate the impact that stress testing and formal capital planning (CCAR) is having on US banks

- ***“The frequency and quality of discussion with my CEO and the board is totally different from before the crisis”***
- ***“The work-load is incredible – but it has forced interaction across groups that rarely did so before”***
- ***“PPNR risk dynamics were poorly understood before CCAR”***
- ***“We have much better quality models and risk awareness”***

But there is a real risk that CCAR devolves into a compliance exercise

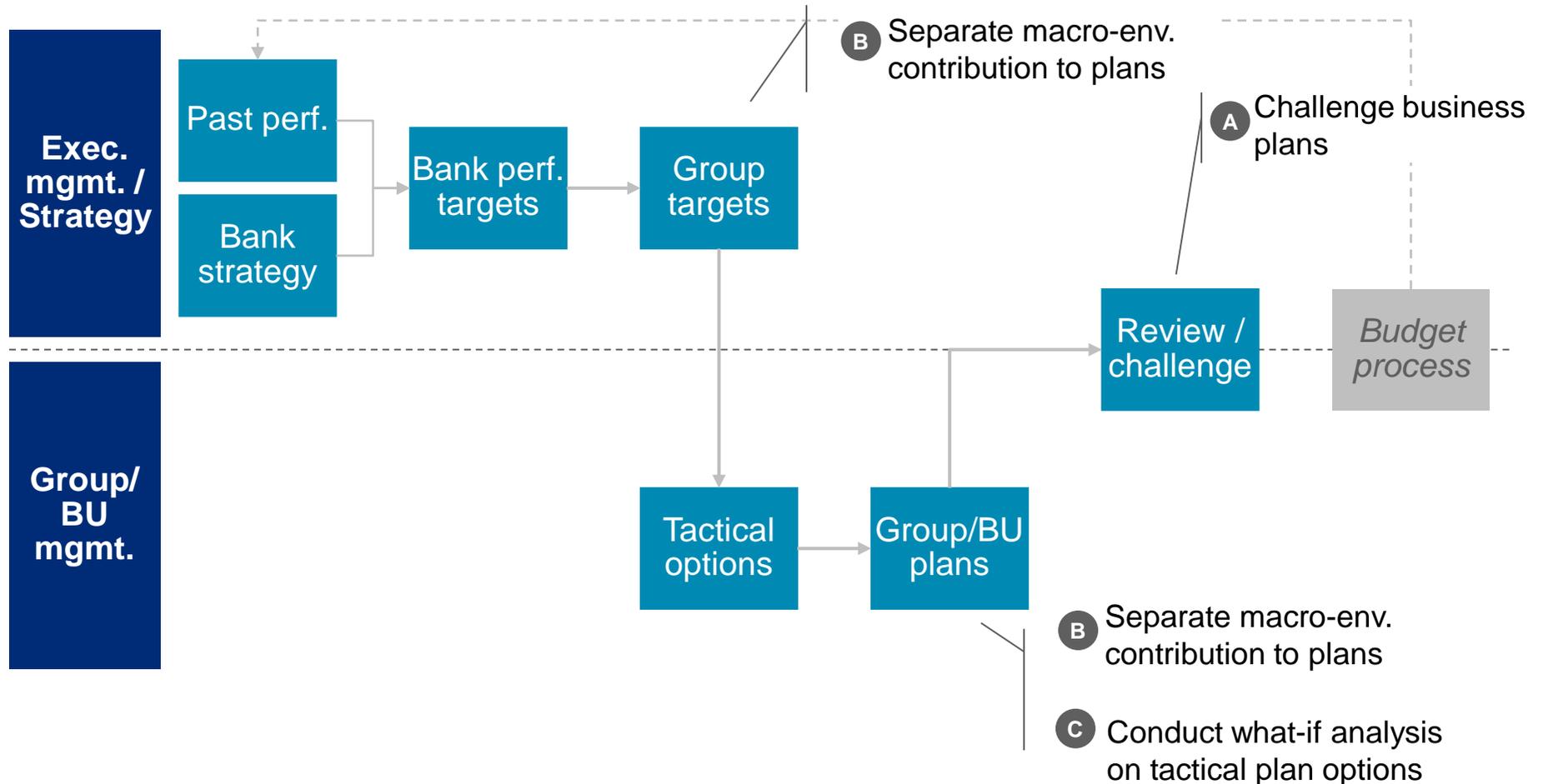
- Stakes are high, so focus is on outcome – “passing” – instead of process
- Process and workload intensity forces routinization
- “What do I need to do to keep the regulator happy”
 - Instead of: “What are my strengths and weaknesses – and how should that inform my strategy and the resources needed to support it”

So how can we use the CCAR machinery for “Business as Usual”?

Banks comfortable with CCAR are actively applying it to strategic planning

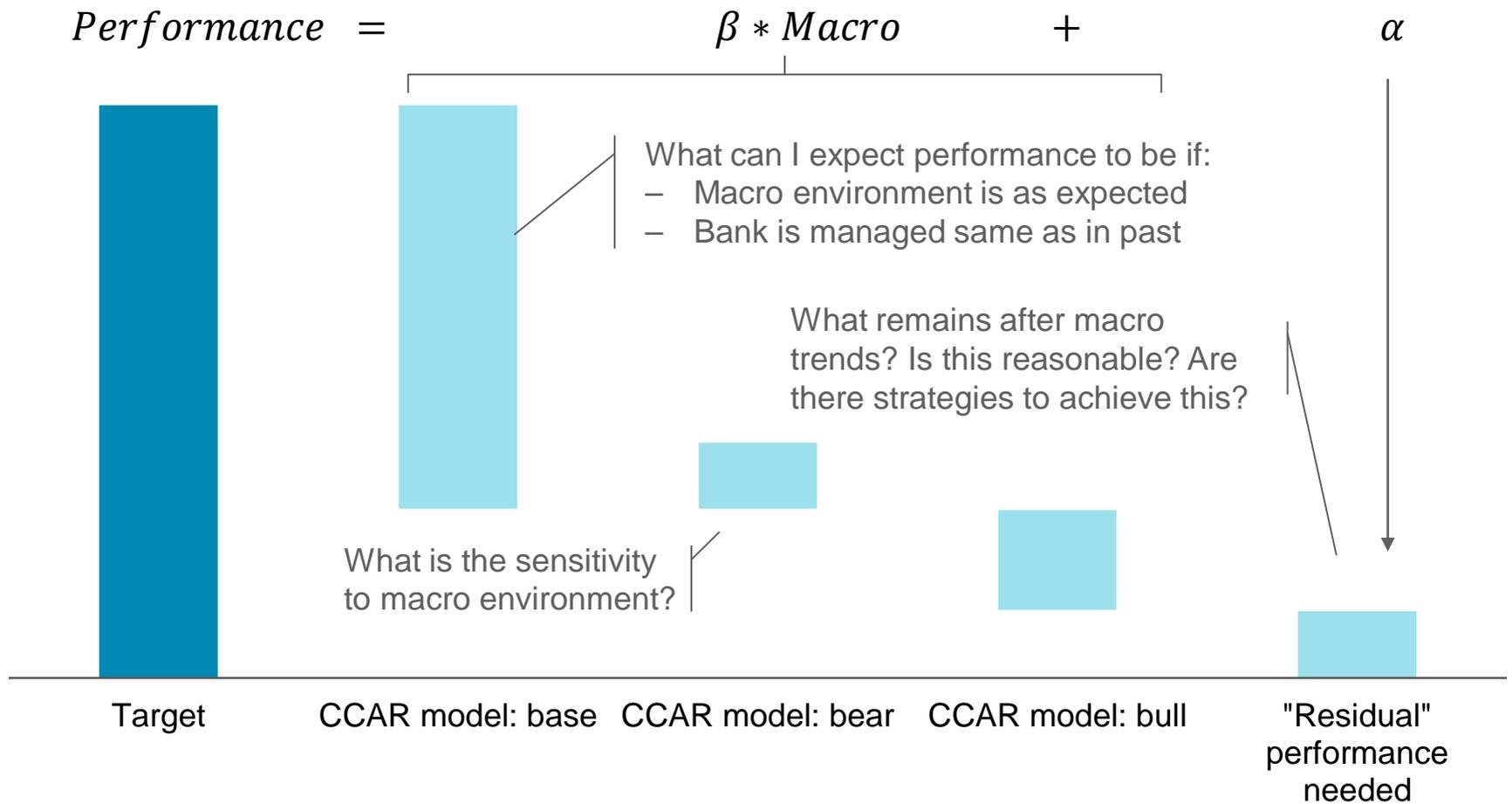
High-level strategic planning process

Client example



Scenario-based planning

Using CCAR models for strategic planning



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