

Financial Research Advisory Committee Meeting

February 25, 2016

Discussion Topic: Stress Test Program

The Dodd-Frank Act directs the OFR to evaluate and report on stress tests. The mandate is broad — not limited to stress testing of banks. The OFR’s stress testing program has three parts, covering banks, nonbanks, and the U.S. financial system as a whole.

The bank stress testing part of the program is well underway. We have published several working papers and briefs on bank stress testing and will be extending this research.

Stress testing of nonbank financial institutions aims to address several questions. Which types of nonbank financial institutions should perform stress tests? What should those tests look like? How effective are current stress tests? What improvements should regulators consider?

Stress tests of individual institutions could shed light on parts of financial activities and firms potentially posing more risk to financial stability. Those activities and firms might warrant additional Financial Stability Oversight Council attention. However, the impact of stresses on individual firms or types of firms can spread through financial markets or connections across firms to other parts of the financial system. Thus, rounding out the OFR’s stress testing program is research on stress testing of the entire U.S. financial system.

This program has three components:

1. Compile supervisory data needed to evaluate stress-testing methodologies.
2. Develop coherent stress scenarios beyond those currently used.
3. Conduct research on methodologies for stress testing of individual firms and the U.S. financial sector as a whole.

Questions for discussion

1. How should we prioritize the program components?
2. How should we analyze the way stress tests reflect different risks in different financial firms and activities?
3. Should stress test scenarios be based on historical experience, or should they use other techniques to assess vulnerabilities?